

111TH CONGRESS }
2d Session

SENATE

{ REPORT
111-187

SOCIAL SECURITY MODERNIZATION: OP-
TIONS TO ADDRESS SOLVENCY AND BEN-
EFIT ADEQUACY

R E P O R T

OF THE

SPECIAL COMMITTEE ON AGING
UNITED STATES SENATE



MAY 13, 2010.—Ordered to be printed

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LETTER OF TRANSMITTAL

U.S. SENATE,
SPECIAL COMMITTEE ON AGING,
Washington, DC.

Hon. JOE BIDEN,
President, U.S. Senate,
Washington, DC.

DEAR MR. PRESIDENT: Under authority of Senate Resolution 73 agreed to March 10, 2009, I am submitting to you a report of the U.S. Senate Special Committee on Aging entitled: Social Security Modernization: Options To Address Solvency and Benefit Adequacy.

Senate Resolution 4, the Committee Systems Reorganization Amendments of 1977, authorizes the Special Committee on Aging “to conduct a continuing study of any and all matters pertaining to problems and opportunities of older people, including but not limited to, problems and opportunities of maintaining health, of assuring adequate income, of finding employment, of engaging in productive and rewarding activity, of securing proper housing and, when necessary, of obtaining care and assistance.” Senate Resolution 4 also requires that the results of these studies and recommendation be reported to the Senate annually.

This Aging Committee report, together with the testimony received during a June 2009 hearing on the topic of Social Security, outlines the challenges currently facing Social Security’s retirement program and highlights options for addressing program solvency, benefit adequacy, and retirement income security for economically-vulnerable groups. The options described in this report represent a range of proposals that are commonly considered and should not be construed as proposals that have been endorsed by the Committee or its members. Many members of the Committee, including myself, do not support and actively oppose many of the options. However, a full and informed debate begins with the collection of research and information, and it is our hope that this report will serve as a resource to Congress and policymakers as they discuss ways to ensure that Social Security will remain strong for another 75 years.

I am pleased to transmit this report to you.

Sincerely,

HERB KOHL,
Chairman.

FOREWORD

Since its inception, the Special Committee on Aging (Aging Committee) has examined various aspects of the Old-Age, Survivors, and Disability program—otherwise known as Social Security—in an effort to assist Congress in devising ways to strengthen this critical program for seniors. For nearly 75 years, Social Security has served as the foundation of retirement income for American workers and their families, dramatically reducing poverty among our nation's elderly. Today, it is estimated that 44 percent of older Americans would be considered poor by federal standards if they did not receive Social Security benefits. And for the majority of retired Americans, Social Security serves as their primary source of income.

Although Social Security remains a crucial benefit for millions of seniors, the program was designed to serve an American society of 75 years ago. Much has changed since its inception: Americans are living longer, women's participation in the labor force has significantly increased, and with a rise in the divorce rate, household composition has changed. In addition, the labor force is growing more slowly and the nature of work and compensation has altered in ways that affect workers' ability to save for retirement. As a result, under its current design, Social Security may not be as effective as it could be in addressing the needs of our society both now and in the future. Therefore, modernizing the program to reflect America's evolving demographics is vital to ensuring that benefits are adequate and equitable for generations to come.

Social Security also faces fiscal challenges. The 2009 report of the Social Security Board of Trustees projects that the program will continue to add tax revenue to its Trust Funds through 2016, after which it will need to subsidize its revenues by drawing from the Trust Funds in order to pay out full benefits. By 2037, the Trustees estimate that the reserves will be depleted. Since the Social Security program is prohibited from borrowing, tax revenues at that point would only be sufficient to pay out roughly 76 percent of benefits. Congress should enact modest changes to Social Security in the near future in order to bring its long-term financing into balance and improve benefits for those who need them most.

This Aging Committee report, together with the testimony received during a June 2009 hearing on the topic of Social Security, outlines the challenges currently facing Social Security's retirement program and highlights options for addressing program solvency, benefit adequacy, and retirement income security for economically-vulnerable groups. The options described in this report represent a range of proposals that are commonly considered and should not be construed as proposals that have been endorsed by the Committee or its members. Many members of the Committee, including myself, do not support and actively oppose many of the options. How-

ever, a full and informed debate begins with the collection of research and information, and it is our hope that this report will serve as a resource to Congress and policymakers as they discuss ways to ensure that Social Security will remain strong for another 75 years.

HERB KOHL,
Chairman.

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SOCIAL SECURITY MODERNIZATION: OPTIONS TO
ADDRESS SOLVENCY AND BENEFIT ADEQUACY

MAY 13, 2010.—Ordered to be printed

Mr. KOHL, from the Special Committee on Aging,
submitted the following

R E P O R T

COMMITTEE JURISDICTION

It shall be the duty of the special committee to conduct a continuing study of any and all matters pertaining to problems and opportunities of older people, including, but not limited to, problems and opportunities of maintaining health, of assuring adequate income, of finding employment, of engaging in productive and rewarding activity, of securing proper housing, and when necessary, of obtaining care or assistance.

Source: SPECIAL COMMITTEE ON AGING, Jurisdiction and Authority, S. Res. 4, 104, 95th Cong., 1st Sess. (1977) \\\ As amended by S. Res. 78, 95th Cong., 1st Sess. (1977), S. Res. 376, 95th Cong., 2d Sess. (1978), S. Res. 274, 96th Cong., 1st Sess. (1979), S. Res. 389, 96th Cong., 2d Sess. (1980).

A Committee is a panel of members elected or appointed to perform some service or function for its parent body. The legislative subjects and other functions are assigned to a committee by rule, precedent, resolution, or statute. In general, committees conduct investigations, make studies, issue reports, and make recommendations. Select or Special Committees are established by a resolution for a special purpose and, usually, for a limited time. Most select and special committees are assigned specific investigations or studies, but are not authorized to report measures to their chambers. Within the assigned areas, these functional subunits gather information; compare and evaluate legislative alternatives; identify policy problems and propose solutions; select, determine, and report measures for full chamber consideration; monitor executive branch performance (oversight); and investigate allegations of wrongdoing. While special committees have no legislative authority, they can study issues, conduct oversight of programs, and investigate reports of fraud and waste.

COMMITTEE BACKGROUND

The Senate Special Committee on Aging was first established in 1961 as a temporary Committee of the U.S. Senate, and was granted permanent status on February 1, 1977. While special committees have no legislative authority, Congress relies on them to study issues, conduct oversight of programs, and investigate reports of fraud, waste, and abuse. Throughout its existence, the Aging Committee has served as a focal point in the Senate for discussion and debate on matters relating to older Americans, and often submits its findings and legislative recommendations to the Senate, as well as publishes materials of assistance to those interested in public policies related to the aging and elderly.

The Aging Committee has a long and influential history, and has called the Congress' and the nation's attention to many problems affecting older Americans. The Aging Committee was exploring health insurance coverage of older Americans prior to the enactment of Medicare in 1965. Since the passage of that legislation, the Aging Committee has continually reviewed Medicare's performance on an almost annual basis. The Aging Committee has also regularly reviewed pension coverage and employment opportunities for older Americans. It has conducted oversight of the administration of major programs like Social Security and the Older Americans Act. Finally, it has crusaded against frauds targeting the elderly and federal programs on which the elderly depend.

SENATE COMMITTEE HEARINGS

Committee hearings afford Senators an opportunity to gather information on, and draw attention to, legislation and issues within a committee's purview, conduct oversight of programs or agencies, and investigate allegations of wrongdoing.

Hearings are committee or subcommittee meetings to receive testimony for legislative, investigative, or oversight purposes. Witnesses often include government officials, spokespersons for interested groups, experts, officials from the Government Accountability Office, and members of Congress. Committees may issue subpoenas to summon reluctant witnesses. Both houses require that the vast majority of hearings be open to the media and public and, if possible, publicly announced at least a week before they begin.

Witnesses before Senate committees (except Appropriations) generally must provide a committee with a copy of their written testimony at least one day prior to their oral testimony [Rule XXVI, paragraph 4(b)]. It is common practice to request witnesses to limit their oral remarks to a brief summary of the written testimony. A question and answer period usually follows the witnesses' oral testimony. Following hearings, committees usually publish the transcripts of witness testimony and questions and answers.

Congressional committee hearings may be broadly classified into four types: 1) legislative, 2) oversight, 3) investigative, and 4) confirmation. Hearings may be held on Capitol Hill or elsewhere, such as a committee member's district or state or a site related to the subject of the hearing. All hearings have a similar formal purpose, to gather information for use by the committee in its activities.

RELEVANT AGING COMMITTEE HEARINGS

<http://aging.senate.gov/hearings.cfm>

111th Congress

Social Security: Keeping the Promise in the 21st Century, June 18, 2009

Boomer Bust? Securing Retirement in a Volatile Economy, February 25, 2009

Saving Smartly for Retirement: Are Americans Being Encouraged To Break Open The Piggy Bank?, July 16, 2008

The Aging Workforce: What Does It Mean For Businesses And The Economy?, February 28, 2007

109th Congress

Social Security: Do We Have To Act Now?, February 3, 2005

108th Congress

Analyzing Social Security: GAO Weighs the President's Commission's Proposals, January 15, 2003

Social Security: Whose Trust Will Be Broken?, July 29, 2003

Strengthening Social Security: What Can We Learn From Other Nations?, May 18, 2004

Strengthening Social Security: What Can Personal Retirement Accounts Do For Low-Income Workers?, June 15, 2004

107th Congress

Straight Shooting on Social Security: The Trade-offs of Reform, December 10, 2001

106th Congress

Inviting Fraud: Has the Social Security Administration Allowed Some Payees to Deceive the Elderly and Disabled?, May 2, 2000

Income Taxes: The Solution to the Social Security and Medicare Crisis?, March 27, 2000

The Impact of Social Security Reform on Women, June 1, 1999

Social Security Reform: Is More Money the Answer?, March 1, 1999

Women and Social Security Reform: Are Individual Accounts the Answer?, February 22, 1999

105th Congress

2010 and Beyond: Preparing Social Security for the Baby Boomers, Omaha, NB, August 26, 1997

A Starting Point for Reform: Identifying the Goals of Social Security, February 10, 1998

The Stock Market and Social Security: The Risks and the Rewards, April 22, 1998

104th Congress

Social Security Reform Options: Preparing for the 21st Century, September 24, 1996

Problems in the Social Security Disability Programs: The Disabling of America, March 2, 1995

101st Congress

New Directions for SSA: Revitalizing Service, May 18, 1990

SSA's Toll-Free Telephone System: Service or Disservice?, April 10, 1989

100th Congress

The Social Security Notch: Justice or Injustice?, February 22, 1988

99th Congress

The Closing of Social Security Field Offices, Pittsburgh, PA September 9, 1985

98th Congress

Social Security Disability Reviews: The Human Costs:

Part 1: Chicago, IL, February 16, 1984

Part 2: Dallas, TX, February 17, 1984

Part 3: Hot Springs, AR, March 24, 1984

Social Security Reviews of the Mentally Disabled, April 7-8, 1983

Social Security: How Well Is It Serving the Public?, November 29, 1983

97th Congress

Social Security Disability: The Effects of the Accelerated Review, Ft. Smith, AR, November 19, 1982

Social Security Reform and Retirement Income Policy, September 16, 1981

The Social Security System: Averting the Crisis, Evanston, IL, August 10, 1981

Social Security Reform: Effect on Work and Income after Age 65, Rogers, AR, May 18, 1981

Social Security Oversight:

Part 1: (Short-Term Financing Issues), June 16, 1981

Part 2: (Early Retirement), June 18, 1981

Part 3: (Cost-of-Living Adjustments), June 24, 1981

96th Congress

Social Security: What Changes Are Necessary?:

Part 1: Washington, DC, November 21, 1980

Part 2: Washington, DC, December 2, 1980

Part 3: Washington, DC, December 3, 1980

Part 4: Washington, DC, December 4, 1980

Adapting Social Security to a Changing Work Force, November 28, 1979

94th Congress

Future Directions in Social Security:

Part 9: Washington, DC, March 18, 1975

Part 10: Washington, DC, March 19, 1975

Part 11: Washington, DC, March 20, 1975

Part 12: Washington, DC, May 1, 1975

Part 13: San Francisco, CA, May 15, 1975

Part 14: Los Angeles, CA, May 16, 1975

Part 15: Des Moines, IA, May 19, 1975

Part 16: Newark, NJ, June 30, 1975

Part 17: Toms River, NJ, September 8, 1975

Part 18: Washington, DC, October 22, 1975

Part 19: Washington, DC, October 23, 1975

Part 20: Portland, OR, November 24, 1975

Part 21: Portland, OR, November 25, 1975

Part 22: Nashville, TN, December 6, 1975

Part 23: Boston, MA, December 19, 1975

Future Directions of Social Security:

Part 24: Providence, RI, January 26, 1976

Part 25: Memphis, TN, February 13, 1976

93rd Congress

Future Directions in Social Security:

Part 1: Washington, DC, January 15, 1973

Part 2: Washington, DC, January 22, 1973

Part 3: Washington, DC, January 23, 1973

Part 4: Washington, DC, July 25, 1973

Part 5: Washington, DC, July 26, 1973

Part 6: Twin Falls, ID, May 16, 1974

Part 7: Washington, DC, July 15, 1974

Part 8: Washington, DC, July 16, 1974

AGING COMMITTEE REPORT

Executive Summary**About This Report**

The Chairman and Ranking Members of the Aging Committee and its individual members do not support all of the options discussed in this report. In fact, many of the options are opposed by individual members of the Committee. Nevertheless, the report is written in the spirit of creating an open and informed debate on the range of options to improve both solvency and benefit adequacy.

The options presented represent a common, but by no means exhaustive, list of policies Congress could institute. There are therefore numerous combinations of changes to tax and benefit provisions that could be considered. Further, this report focuses on possible changes to the Social Security retirement program and does not offer proposals for reforming the Social Security Disability Insurance program.

This report uses estimates of the 2009 Social Security Trustees Report¹ as a basis for analysis. The 2010 Trustees report, which will be issued in June of this year, will likely have different estimates of the Trust Funds' solvency due to the impact of the economic downturn reducing revenues and increasing the number of new beneficiaries.

Overview

Since its inception, the Senate Special Committee on Aging (Aging Committee) has examined various aspects of the Old-Age, Survivors, and Disability program—otherwise known as Social Security—in an effort to assist Congress in devising ways to strengthen this critical program for seniors. This Aging Committee report, together with the testimony received during a June 2009 hearing on Social Security, outlines the challenges currently facing Social Security's retirement program and highlights options for addressing program solvency, benefit adequacy, and retirement income security for economically-vulnerable groups. It does not offer proposals for reforming the Social Security Disability Insurance program.

Modernizing Social Security means ensuring the program is both solvent and effective, for all Americans, now and in the future. Efforts to improve solvency may enhance, weaken or have no impact on the ability of Social Security to provide retirement security for all Americans, whereas efforts to improve the adequacy of benefits will likely come at a cost to the system.

¹ *The 2009 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Disability Insurance Trust Fund*, May 12, 2009, available at: <http://www.ssa.gov/OACT/TR/2009/tr09.pdf> (hereafter cited as the 2009 Social Security Trustees' Report).

Timing also plays a role in the decisions that must be made. Modernizing the program will become increasingly difficult as the Social Security Trust Funds diminish, therefore it will be easier and less costly to make changes now. So it is with some urgency that Congress should simultaneously address the twin challenges of solvency and effectiveness, and because the program is critical to every American family, it should be done in a bipartisan and transparent way.

A full and informed debate on how to tackle these challenges begins with the collection of relevant options. It is our hope that this report will serve as a resource to Congress and policymakers as they discuss the future of the Social Security.

The Promise and Challenges of Social Security

Social Security benefits, while not generous, provide an important source of income for retired Americans and serve as the foundation of retirement income for the majority of retirees. In 2009, the average monthly retirement benefit was \$1,164. Although Social Security is not meant to be the sole source of income for retirees, in 2008 nearly one-quarter of beneficiaries age 65 and older lived in households that relied on it for at least 90 percent of household income. These individuals were mostly single women and Social Security's oldest beneficiaries.

The Social Security program faces a modest long-term financing shortfall of tax revenue and interest on Trust Fund assets. The Social Security Trustees estimated in 2009 that the Old Age, Survivors, and Disability Insurance program will continue to add tax revenue to their Trust Funds up to 2016. The Trust Funds will continue to grow because of interest earned through 2023, at which time total assets will be \$4.3 trillion. Subsequently, Social Security will gradually draw down all reserves before the end of 2037, at which point it will have sufficient resources to pay about three-quarters of scheduled benefits. Congress could take steps to modify the program's financing and benefit structure in order to ensure that full benefits continue to be paid after 2037.

The pressure on Social Security's finances comes primarily from the dramatic changes in birthrates and life expectancy that have taken place since the program's inception in the 1930s, and the increase in income inequality over the last several decades. First, the aging of the baby boom generation and increases in life expectancy will continue to contribute to an older society, and between 2010 and 2030, the number of people aged 65 and older is estimated to increase by 75 percent. At the same time, the number of workers whose taxes will finance future benefits is projected to increase by only 14 percent.

Program design features contribute to the projected growth in program spending and program revenues. For example, elements of the Social Security benefit formula are indexed to average wage growth, resulting in an increase in the real (inflation-adjusted) value of benefits for future retirees. This feature ensures that benefits will replace a relatively constant share of a beneficiary's earnings in retirement, but it also means Social Security outlays increase over time as the number of beneficiaries grow. However, increasing wage growth has an offsetting positive effect of increasing revenues as payrolls rise over time.

Finally, rising income inequality in the last several decades has caused the share of aggregate earnings that are not taxed to increase from 10 percent to 17 percent, as high-income workers have seen their salaries rise faster than the Social Security taxable earnings threshold. This means revenues for the Social Security Trust Funds are lower than they would have been if earnings were distributed more evenly among American workers as they were in previous decades.

Economic and demographic changes are also having an impact on other sources of retirement income. Improvements in longevity have increased the likelihood that retirees will outlive their retirement savings, and the rise in the divorce rate and the shortening of average marriages have left more single individuals who will not benefit from spousal protections. Furthermore, the proportion of individuals who depend on Social Security for the majority of their income may grow over time due to the decline in defined benefit pensions, the recent decline the value of retirement accounts, and the relatively slow growth in wages for low and moderate income workers over the last several decades.

Keeping the Promise: Options to Address Solvency and Benefit Adequacy

Congress could implement a range of options to effectively modernize the Social Security retirement program, simultaneously improving the program's solvency and ensuring benefits remain adequate for the elderly and economically-vulnerable beneficiaries. In an effort to highlight both types of options and their implications, this report presents information from the National Academy of Social Insurance (NASI), the Congressional Research Service (CRS), and the U.S. Government Accountability Office (GAO), and assessments of their fiscal impacts on solvency by the Social Security Actuaries. These options to improve solvency and benefit adequacy discussed in this report are summarized in the tables below:

Protecting the stability of Social Security: Options to address program solvency			
Description	Income as percent of taxable payroll	Percentage decrease in shortfall	Page number
<i>Raise Revenue for Program Solvency</i>			
Increase the Social Security Contribution Rate			
Increase Worker and Employer Contributions by 1.1 percent.	2.09	104	
Increase Worker and Employer Contributions by One percent in 2022, and by an Additional One percent in 2052.	2.06	103	
Increase Worker and Employer Contributions 1/20 percent Annually for 20 years.	1.39	69	
Raise Rates Based on the Trustees' Most Current Intermediate Assumptions of the Tax Rate Needed to Balance Revenues and Outlays	varies	100	
Enhance Collection of Existing Taxes	No estimate	No estimate	
<i>Broaden the Revenue Base for Social Security</i>			
Modify the Social Security Tax Cap			
Eliminate the Cap – Do Not Count the Additional Earnings	2.32	116	
Eliminate the Cap – Count the Earnings toward Benefits	1.89	95	
Eliminate the Cap – Count Earnings toward Benefits Using Different Formula	2.17	108	
Gradually Restore the Cap to Cover 90 percent of Earnings	0.60	28	
Gradually Restore the Cap to Cover 90 percent of Earnings for Workers and Eliminate the Contribution Cap for Employers	1.37	69	
Extend Social Security Coverage to all Workers			
Extend Social Security Coverage to Newly-Hired Non-covered State and Local Government Employees	0.17	9	
Treat All Salary Reduction Plans Like 401(k)s	0.25	12	

Description	Income as percent of taxable payroll	Percentage decrease in shortfall	Page number
Use Progressive Taxes to Cover Social Security's Legacy Costs			
Dedicate Estate Tax Revenue at the 2009 Level to Social Security	0.40	20	
Three percent Legacy Tax on Earnings Above the Tax Cap	0.57	28	
Three percent Legacy Tax on AGI over \$250,000 for Couples and \$125,000 for Individuals	0.74	37	
Five percent Legacy Tax on AGI over \$250,000 for Couples and \$125,000 for Individuals	1.23	62	
Maintain Reserves and Diversify Investments			
Gradually Invest 15 percent of Trust Fund Assets in Equities (with assumed nominal rate of return on equities of 9.4%)	0.27	14	
Gradually Invest 40 percent of Trust Fund Assets in Equities (with assumed nominal rate of return on equities of 9.4%)	0.67	33	
<i>Reduce Benefits to Address Program Solvency</i>			
Reduce the Cost-Of-Living Adjustment			
Reduce the COLA by One percent Each Year	1.55	78	
Reduce the COLA by One-half percent Each Year	0.81	40	
Adopt the "Chained" Consumer Price Index (CPI)	0.49	24	
Raising the Age for Full Retirement Benefits			
Accelerate the Increase to 67; Then Increase the Full-Benefit Age by One Month Every Two Years to Age 68	0.46	23	
Accelerate the Increase to 67; Then Increase the Full-Benefit Age by One Month Every Two Years to Age 70	0.62	31	
Gradually Index the Full-benefit Age for Longevity Indefinitely	0.40	18	

Description	Income as percent of taxable payroll	Percentage decrease in shortfall	Page number
Lengthen the Career-Earnings Averaging Period			
Increase the Averaging Period from 35 to 38 Years	0.29	14	
Increase the Averaging Period from 35 to 40 Years	0.46	23	
Reduce Benefits for New Beneficiaries			
Reduce Benefits by Three percent for New Beneficiaries in 2010 and Later	0.36	18	
Reduce Benefits by Five percent for New Beneficiaries in 2010 and Later	0.61	30	
Price Index Benefits for Successive Generations Beginning in 2013	1.31	65	
Gradually Lower the Supplemental Spouse Benefit	0.12	6	

Protecting the Effectiveness of Social Security: GAO Options to Protect Vulnerable Groups	
Option	Page Number
Guaranteeing a Minimum Benefit Guaranteeing a minimum benefit by increasing Social Security retirement benefits for those who have worked in low-wage jobs throughout their careers.	
Reducing Work Requirements for Eligibility Reducing the work requirements for Social Security retirement benefit eligibility, allowing people who have shorter earnings histories to receive benefits.	
Supplementing Benefits for Low-income Single Workers Supplementing benefits for low-income single workers by adjusting the formula used to calculate Social Security retirement benefits.	
Adopting Earnings Sharing Earnings sharing combines married individuals' annual earnings and evenly divides them between the two spouses for each year of marriage when calculating individuals' Social Security retirement benefits. Each spouse accrues an individual benefit, even if only one of them worked.	
Reducing the Marriage Duration Required for Spousal Benefits Reducing the number of years a marriage needed for a divorced person to receive spousal benefits thereby increasing the number of people who are eligible to receive Social Security spousal benefits.	
Providing Caregiver Credits Providing caregiver credits increases benefits for those who spend time out of the workforce to care for dependent children or elderly relatives.	
Increasing Survivor Benefits Increasing benefits for surviving spouses, often widowed women, by providing a Social Security retirement benefit equal to 75 percent of the combined amount the couple received.	
Providing Longevity Insurance Longevity insurance seeks to reduce the risk that people fall into poverty at older ages by increasing Social Security retirement benefits for beneficiaries who reach an advanced age.	

These options described in this report demonstrate that the challenges facing Social Security, despite their size and complexity, can be resolved. However, it is important to provide some context to the information. The estimates on solvency are calculated by Social Security

Administration actuaries with the assumption that all other elements of Social Security remain the same. Further, options to increase solvency may not impact everyone in the same way - some recipients may see their Social Security taxes and benefits change, while others may not - and the impacts of proposals should be examined for both current beneficiaries and future generations of retirees, as many options phase in over time. Combining options requires new estimates to predict their effects on solvency and the various sub-populations of beneficiaries. Importantly, Social Security solvency and effectiveness are separate factors, but should be analyzed together.

Congress should act to ensure that Social Security will remain strong for another 75 years and provide future generations of Americans with economic security. The Aging Committee will support this effort by continuing to seek ideas and evaluate options for Social Security modernization.

Introduction

Title II of the Social Security Act, as amended, established the Old-Age, Survivors, and Disability Insurance (OASDI) program, which is generally known as Social Security. Since the 1930s, many American seniors have depended on its benefits as a significant part of their retirement income, and the program has significantly decreased poverty among the elderly. However, the Social Security program will face increasing challenges in the future as an aging American population begins to strain the program financially. Even though the program is currently financially strong, Congressional action is needed to ensure fiscal stability for years to come. This Committee report highlights potential options for addressing the solvency and benefit adequacy of the Social Security retirement program.²

Background

The Social Security Act, signed into law by Franklin Roosevelt on August 14, 1935, formed the basis of an old-age insurance program by providing income security to workers aged 65 and older in most commerce and industry. Although the Great Depression provided the catalyst for the landmark legislation, its principles were rooted in social insurance, which required payment of benefits based on contributions from workers. It became effective only in 1937 and therefore was not intended to provide immediate economic relief from the effects of the Depression. It was meant to smooth out large fluctuations in income typical in an industrial society.

The Social Security program has evolved in significant ways over the past seven decades.³ With the 1939 amendments, it became more family-based by expanding the program from workers only to include dependents and survivors of workers. In 1950 and later, amendments expanded the program to make it more universal. States could, under certain conditions, provide coverage to their employees. Also covered were regularly-employed farm and domestic workers and, with some exceptions, most self-employed workers. The Disability program was added to the Social Security program in 1956. The 1983 amendments prohibited states from opting out of the system, and in 1990 coverage for state employees became mandatory, if state and local employees did not have a state or local government pension plan.

The expansionary period of the early four decades has been followed by a period where concerns have focused on the long-range financing of the program. The 1977 amendments focused on stabilizing costs and addressing the revenue side of the program. The 1983 amendments addressed financial problems by extending coverage to bring more workers into the system, subjecting a portion of Social Security benefits to income taxation, scheduling changes

² This report does not address options for strengthening disability insurance.

³ 'Social Security: A Program and Policy History,' by Patricia Martin and David Weaver, *Social Security Bulletin*, Vol.66, No.1, 2005. <http://www.ssa.gov/policy/docs/ssb/v66n1/v66n1p1.pdf>

in the payroll tax rate, and adopting a phased-in increase in the full retirement age starting for workers born in 1938 or later.

Despite the evolution of the OASDI program over the decades, two core principles—contributory in nature and progressivity—continue to define the program. Benefits are determined by work in covered employment, and benefits replace a higher share of earnings for lower wage earners than for higher wage earners. This progressivity is in part to compensate for the shorter life expectancies of lower-wage earners, and in part to take into account the decreased ability low wage earners have to cope with income reductions or supplement their benefits with private savings. The success of the program in bringing about a sharp reduction in poverty among the elderly is well-documented. Any changes to the program today will need to address the dual challenges of meeting the adequacy needs of vulnerable groups and confronting the financing needs of the program, while ensuring that the program remains fair and effective for all Americans.

How Does the Social Security Program Work?

The Social Security program provides monthly cash benefits to retired and disabled workers and their dependents, and to the survivors of deceased workers. To qualify for benefits, individuals must work in Social Security-covered employment for a specified period of time. Generally, a worker needs 40 credits to become “insured” for benefits (fewer credits are needed for disability and survivor benefits, depending on the worker’s age at the time he or she became disabled or died).⁴ In 2010, a worker earns one credit for each \$1,120 in covered earnings, up to a maximum of four credits for the year (based on annual earnings of \$4,480 or more).⁵

Most jobs in the United States are covered under Social Security. In 2010, 94 percent of workers in paid employment or self-employment are covered by Social Security.⁶ The major categories of workers who are *exempt* from Social Security coverage are:

1. State and local government workers participating in alternative retirement systems (Medicare Hospital Insurance (HI) tax is mandatory for State and local government workers hired since April 1, 1986);
2. Election workers earning \$1,500 or less in 2010;
3. Ministers who choose not to be covered, and certain religious sects;
4. Federal workers hired before 1984 (the HI portion is mandatory for all Federal workers);⁷
5. College students working at their academic institutions;
6. Household workers earning less than \$1,700 in 2010, or those under age 18 for whom household work is not their principal occupation;

⁴ A minimum of six earnings credits (or 1½ years of covered employment) is needed to qualify for benefits.

⁵ The amount of earnings needed for one credit is indexed to average wage growth.

⁶ Social Security Administration, *2010 Social Security/SSI/Medicare Information*, December 28, 2009. Available at <http://www.socialsecurity.gov/legislation/2010factsheet.pdf>.

⁷ Elected office holders, political appointees, and judges are mandatorily covered by both Social Security and HI regardless of when their service began.

7. Self-employed workers with annual net earnings below \$400;
8. Foreign students and exchange visitors who hold F-1, J-1, M-1, Q1, and Q2 visas if the work is performed in connection with their studies or for the purpose of their visit to the United States;⁸ and
9. Foreign agricultural workers who hold H-2A visas.

In 2008, of a total work force of approximately 173.6 million workers, an estimated 162.4 million workers were covered under Social Security (see **Table 1**).

TABLE 1: ESTIMATED SOCIAL SECURITY COVERAGE, 2008

	Total (millions)	Non- covered (millions)	Percent covered
Workers ¹	173.6	11.2	93.6
Jobs:			
State and local government ²	23.1	5.6	75.8
Federal civilian	3.7	0.5	86.5
Students ³	1.5	1.5	0.0

¹ Includes both wage and salary and self-employed workers.

² Excludes students.

³ Includes students employed at both public and private colleges and universities.

Source: Office of the Chief Actuary, Social Security Administration.

In 2008, an estimated 11.2 million workers were not covered under Social Security. The majority of non-covered positions were state and local government jobs. As shown in **Table 2**, 73 percent of state and local government workers overall were covered under Social Security in 2007.

**TABLE 2: ESTIMATED SOCIAL SECURITY COVERAGE OF
WORKERS WITH STATE AND LOCAL GOVERNMENT
EMPLOYMENT, 2007
[BASED ON 1-PERCENT SAMPLE]**

State	All workers	Covered workers	Percent covered
Alabama	390,000	361,100	92.6
Alaska	64,300	42,100	65.5
Arizona	444,300	406,300	91.4
Arkansas	203,300	182,500	89.8
California	2,478,000	1,084,400	43.8
Colorado	409,100	124,300	30.4
Connecticut	287,400	205,900	71.6
Delaware	65,600	61,900	94.4

⁸ J-1 visa holders who are in the United States for 18 months or longer are required to pay Social Security payroll taxes.

District of Columbia	75,400	58,600	77.7
Florida	1,162,800	1,032,800	88.8

**TABLE 2: ESTIMATED SOCIAL SECURITY COVERAGE OF WORKERS WITH
STATE AND LOCAL GOVERNMENT EMPLOYMENT, 2007, continued**

State	All workers	Covered workers	Percent covered
Georgia	699,200	518,700	74.2
Hawaii	113,400	79,700	70.3
Idaho	134,800	127,300	94.4
Illinois	961,600	526,400	54.7
Indiana	497,900	448,500	90.1
Iowa	288,800	261,600	90.6
Kansas	289,200	266,500	92.2
Kentucky	373,300	279,000	74.7
Louisiana	329,700	92,700	28.1
Maine	118,000	63,900	54.2
Maryland	458,300	415,700	90.7
Massachusetts	474,700	20,400	4.3
Michigan	772,600	684,400	88.6
Minnesota	445,100	417,900	93.9
Mississippi	260,900	240,300	92.1
Missouri	463,500	341,600	73.7
Montana	95,700	83,500	87.3
Nebraska	152,200	142,500	93.6
Nevada	159,400	29,500	18.5
New Hampshire	108,100	95,400	88.3
New Jersey	686,800	638,300	92.9
New Mexico	197,400	177,400	89.9
New York	1,734,700	1,681,800	97.0
North Carolina	713,100	659,700	92.5
North Dakota	74,900	65,300	87.2
Ohio	845,800	21,700	2.6
Oklahoma	310,500	281,800	90.8
Oregon	290,400	267,800	92.2
Pennsylvania	808,600	749,400	92.7
Puerto Rico	257,700	222,700	86.4
Rhode Island	65,200	55,300	84.8
South Carolina	375,800	352,700	93.9
South Dakota	79,200	73,800	93.2
Tennessee	484,900	441,400	91.0
Texas	1,752,600	836,400	47.7
Utah	222,000	202,800	91.4

Vermont 60,700 59,300 97.7

**TABLE 2: ESTIMATED SOCIAL SECURITY COVERAGE OF WORKERS WITH
STATE AND LOCAL GOVERNMENT EMPLOYMENT, 2007, continued**

State	All workers	Covered workers	Percent covered
Virginia	677,200	641,400	94.7
Washington	563,900	500,100	88.7
West Virginia	155,300	144,700	93.2
Wisconsin	484,400	429,900	88.7
Wyoming	78,500	69,200	88.2
Other ¹	6,400	1,300	20.3
Total	23,702,600	17,269,600	72.9

These data are derived from the Social Security Administration, Office of Research Evaluation and Statistics, 1% Continuous Work History Sample (CWHHS) Employee Employer File.

¹ Includes persons employed by American Samoa, Guam, Northern Marianas and Virgin Islands.

Source: Office of Research Evaluation and Statistics, Social Security Administration.

Social Security coverage varies from state to state. For example, approximately 97 percent of state and local employees in New York and Vermont were covered by Social Security compared to approximately 3 percent in Ohio and 4 percent in Massachusetts. This disparity in coverage occurs because though Social Security originally did not cover any state and local government workers, over time the law has changed. Most state and local government employees became covered by Social Security through voluntary agreements between the Social Security Administration and individual states (these agreements are known as "Section 218 agreements" because they are authorized by Section 218 of the Social Security Act). Beginning in July 1991, state and local employees who were not members of a public retirement system were mandatorily covered by Social Security. Those public employees who were already members of a public retirement system through their employment were not mandatorily covered because their state pensions already fulfilled the social insurance functions of Social Security.

Social Security is financed primarily by payroll taxes levied on the wages and self-employment income of covered workers. In 2010, covered workers and their employers are both required to pay 6.2 percent of earnings up to \$106,800, or a maximum of \$6,622 in individual payroll taxes per year. Self-employed workers are required to pay 12.4 percent of net self-employment income up to \$106,800, or a maximum of \$13,243 in self-employment taxes per year.⁹ The annual limit on covered earnings subject to payroll taxes is called the *contribution*

⁹ Note: To reflect the fact that employees split payroll taxes on their salaries between themselves and their employers, the taxable base for the self-employment tax is adjusted downward by 7.65 percent and self-employed workers are allowed to deduct half of their self-employment tax liability for income tax purposes.

and benefit base or the *taxable earnings base*. The taxable earnings base is indexed to average wage growth and is increased if a Social Security Cost of Living Adjustment (COLA) is payable.

The maximum amount of annual earnings subject to payroll taxes from 1950 to 2008 is shown in **Table 3**. The payroll tax rate is fixed under current law. The percentage of covered earnings subject to Social Security payroll taxes has fluctuated over time. In 2008, about 84 percent of total earnings in covered employment were subject to Social Security payroll taxes.

**TABLE 3: EARNINGS COVERED BY THE SOCIAL SECURITY SYSTEM,
1950-2008**

Calendar year	Earnings in covered employment			Contribution and benefit base ¹	Taxable earnings (billions)	Taxable earnings as a percent of total earnings in covered employment
	Wages and salaries (billions)	Self-employment (billions)	Total (billions)			
1950	\$109.8	--	\$109.8	\$3,000	\$87.5	79.7
1955	171.6	\$26.7	198.3	4,200	157.5	79.4
1960	236.0	32.4	268.4	4,800	207.0	77.1
1965	311.4	45.9	357.3	4,800	250.7	70.2
1970	483.6	53.1	536.7	7,800	415.6	77.4
1975	717.2	75.9	793.1	14,100	664.8	83.8
1980	1,235.6	103.7	1,339.3	25,900	1,173.8	87.6
1985	1,802.4	149.6	1,952.0	39,600	1,717.3	88.0
1990	2,510.4	205.9	2,716.3	51,300	2,358.9	86.8
1991	2,566.7	207.9	2,774.6	53,400	2,422.5	87.3
1992	2,709.7	220.7	2,930.4	55,500	2,532.8	86.4
1993	2,808.9	228.0	3,036.9	57,600	2,636.3	86.8
1994	2,973.9	232.7	3,206.6	60,600	2,785.3	86.9
1995	3,164.9	242.3	3,407.2	61,200	2,919.6	85.7
1996	3,347.8	256.0	3,603.8	62,700	3,073.5	85.3
1997	3,608.2	272.1	3,880.3	65,400	3,285.3	84.7
1998	3,907.5	290.4	4,197.9	68,400	3,528.0	84.0
1999	4,173.2	308.0	4,481.3	72,600	3,749.1	83.7
2000	4,514.7	326.4	4,841.1	76,200	4,008.9	82.8
2001	4,609.1	332.4	4,941.5	80,400	4,171.1	84.4
2002	4,612.6	341.6	4,954.1	84,900	4,250.0	85.8
2003	4,727.3	360.3	5,087.6	87,000	4,354.7	85.6
2004	4,994.3	396.9	5,391.2	87,900	4,554.5	84.5
2005	5,252.1	433.8	5,686.0	90,000	4,769.6	83.9
2006	5,598.3	453.3	6,051.6	94,200	5,084.3	83.4
2007	5,899.8	471.8	6,371.6	97,500	5,272.2	82.7
2008	6,079.4	473.3	6,552.8	102,000	5,511.1	84.1

¹ Amounts for 1937-74 and for 1979-81 were set by statute. All other amounts were determined under automatic adjustment provisions of the Social Security Act.

Source: Office of the Chief Actuary, Social Security Administration.

Retirement Benefits

The Social Security program provides benefits to eligible workers and their family members. For retirement benefits, a worker generally needs 40 credits (10 years in covered employment). Full (unreduced) retirement benefits are first payable at the full retirement age (FRA), which ranges from age 65 to age 67 depending on the person's year of birth. A worker may elect to receive retirement benefits as early as age 62, however, his or her benefits are permanently reduced to take into account the longer expected period of benefit receipt. In addition, a worker may elect to postpone benefit receipt until after the FRA, and receive an increase in benefits based on delayed retirement credits that are payable from the FRA, up to age 70.

Disability Benefits

Although this report is not intended to address the disability insurance provided under Social Security, it is important to understand that such benefits are available under the larger program. To be eligible for disability benefits, a worker must be: (1) insured and (2) disabled according to the definition of disability. To be insured, a worker must have worked a minimum amount of time in employment covered by Social Security (similar to eligibility for retirement benefits). However, for disability benefits, if an individual does not have 40 credits, he or she must have one credit for each year after 1950 or from age 21 up to the onset of disability. In addition, a work test requires the worker to have 20 credits in the 40 quarters preceding the onset of disability (generally five years of covered employment in the last 10 years). Workers under age 31 need to have credit in one-half of the quarters during the period between when they attained age 21 and when they became disabled (a minimum of 6 credits is required). For disability benefits, "disability" is defined as the inability to engage in substantial gainful activity (SGA) by reason of a medically-determinable physical or mental impairment expected to result in death or last at least 12 continuous months.¹⁰ Generally, the worker must be unable to do any kind of work, taking into account age, education and work experience. An initial waiting period of five full months is required before disability benefits are paid.

Supplemental Security Income

The Supplemental Security Income (SSI) Program is also administered by the Social Security Administration, but it is different and separate from Social Security. SSI is a means-tested, federally administered, income assistance program authorized by Title XVI of the Social Security Act. Established in 1972 with benefits first paid in 1974, SSI provides monthly cash

¹⁰ In 2010, the SGA earnings level for non-blind beneficiaries is \$1,000 a month (net of impairment-related work expenses). For blind beneficiaries, the SGA earnings level is \$1,640 a month. Both limits are indexed to average wage growth. For more information, see CRS Report RS20479, *Social Security: Substantial Gainful Activity for the Blind*, available at http://www.aging.senate.gov/crs/crs_social_security_policy.cfm.

payments in accordance with uniform, nationwide eligibility requirements to needy aged, blind, and disabled persons.

The SSI Program is funded by general revenues of the U.S. Treasury whereas Social Security benefits are funded by the Social Security taxes paid by workers, employers, and self-employed persons. The programs also differ in other ways such as the conditions of eligibility and the method of determining payments. In addition, States have the option of supplementing the basic Federal SSI payment.

To qualify for SSI payments, a person must satisfy the program criteria for age, blindness, or disability. The aged are defined as persons 65 years and older. Disabled individuals are those unable to engage in any substantial gainful activity by reason of a medically determined physical or mental impairment expected to last for a continuous period of at least 12 months or result in death. Children may also qualify for SSI if they are under age 18 (or under age 22 if a full-time student), unmarried, and meet the applicable SSI disability¹¹ or blindness, income, and resource requirements. Further, SSI recipients must have limited income, limited resources, (typically defined as \$2000 for an individual and \$3000 for a couple), and meet specific citizenship and residency requirements.¹²

How Are Social Security Benefits Determined?

A worker's monthly Social Security retirement benefit is based on an average of his or her 35 highest-paid earnings years. The worker's entire record of Social Security earnings up through age 60 are indexed to historical wage growth in order to place older wage amounts on the same terms as current wage levels. Earnings after age 60 are not indexed but are included in the benefit computation. The 35 highest years of annual indexed earnings are averaged, and the resulting amount is divided again by 12 to determine the worker's average indexed monthly earnings, or AIME. Some workers do not have 35 years of earnings as a result of unemployment, poor health, or caregiving: for these workers, the years of no earnings are entered as zeros.

The worker's Primary Insurance Amount, or PIA, is found by applying a formula to the AIME. First, AIME is sectioned into three brackets, or levels, of earnings. Three progressive factors—90 percent, 32 percent, and 15 percent—are applied to the three different brackets of AIME. The three products of the factors and AIME are added together. For workers who reach age 62 in 2010, the PIA is determined as follows:

¹¹ For children, the definition of disability under the SSI program is different than the adult standard. Under Sec. 1614(a)(3)(C)(i) of the Social Security Act, disabled means that the child has a medically determinable physical or mental impairment that results in severe functional limitations, and that can be expected to last 12 months or result in death.

¹² For a full description of SSI Eligibility criteria, see Social Security Administration, "Understanding Supplemental Security Income, SSI Eligibility Requirements," 2010 Edition, available at <http://www.socialsecurity.gov/ssi/text-eligibility-ussi.htm>.

TABLE 4: SAMPLE CALCULATION OF A WORKER'S PRIMARY INSURANCE AMOUNT IN 2010

Factor	Average Indexed Monthly Earnings (2010)	Benefit of a Worker with AIME of \$5,000
90 percent	first \$761, plus	\$684.90
32 percent	earnings over \$761 and through \$4,586, plus	\$1,224.00
15 percent	over \$4,586	\$62.10
Total	\$5000	\$1,971.00

The Social Security benefit formula is designed to be progressive. That is, workers with low average lifetime earnings receive a benefit that is a larger proportion of their pre-retirement earnings than do workers with high average lifetime earnings. Progressivity is affected through factors that decline as AIME increases, with the first \$761 of AIME being replaced at a rate of 90 percent, while amounts over \$761 are replaced at rates of 32 percent or 15 percent. The replacement rate for the average earner who claims benefits at the full retirement age in 2010 is about 41 percent of pre-retirement wages. For low-income workers, high income workers, and workers who have earned the maximum taxable amount throughout their careers, the replacement rates in 2010 are about 56 percent, 34 percent and 28 percent, respectively.¹³

The factors (90 percent, 32 percent and 15 percent) are the same each year, but the bracket amounts (\$761 and \$4,586) are indexed to growth in average wages. As noted earlier, as part of determining PIA, a worker's earnings history is brought up to current wage levels by indexing earnings in previous years to wage growth. The result of these provisions is that a worker's initial Social Security benefit is *wage indexed*. Wage indexation of the PIA calculation ensures that benefits replace a similar fraction of pre-retirement income for each successive cohort (as noted above, about 41 percent for a worker with average wages). In other words, wage indexation causes the dollar amount of workers' initial benefits (PIA) to increase from one generation to the next at the rate of increase in the national average wage or, generally, with living standards.

After a worker becomes eligible to receive Social Security benefits, at age 62, the cash benefit amount is adjusted annually through retirement for changes in the Consumer Price Index (CPI). That is, the initial benefit is *price indexed* through retirement, to ensure that inflation does not erode the purchasing power of the individual's initial benefit. Due to increases in worker productivity, wages (and living standards) tend to rise faster than prices when measured over long periods of time.

A worker's Social Security cash benefit may be more or less than PIA. An individual who claims benefits at his or her *full retirement age* (FRA) will receive the full amount of his or

¹³ 2009 Social Security Trustees' Report, Table VI.F10, available at http://www.socialsecurity.gov/OACT/TR/2009/VI_OASDHI_dollars.html#119381.

her PIA. The FRA is the earliest age at which unreduced retirement benefits can be received. The FRA is 65 for persons born before 1938 and is rising gradually to 67 for persons born in 1960 or later.

TABLE 5: SOCIAL SECURITY FULL RETIREMENT AGE BY YEAR OF BIRTH

Year of Birth	Year Age 62 Attained	Full Retirement Age
1936 or earlier	1986-98	65
1937	1999	65
1938	2000	65 and 2 months
1939	2001	65 and 4 months
1940	2002	65 and 6 months
1941	2003	65 and 8 months
1942	2004	65 and 10 months
1943-54	2005-2016	66
1955	2017	66 and 2 months
1956	2018	66 and 4 months
1957	2019	66 and 6 months
1958	2020	66 and 8 months
1959	2021	66 and 10 months
1960 or later	2022 or later	67

Source: Congressional Research Service.

Benefits for the Worker's Family Members

Dependents and survivors of a worker, including surviving children, spouses, former spouses and dependent parents, may be eligible for benefits, as well as survivor benefits if a worker dies. These auxiliary benefits are based on the primary earner's benefit, subject to a maximum family amount. The basis for entitlement to dependents and survivors benefits are summarized in **Table 6**.

Social Security pays a monthly benefit to the *spouse* of an entitled retired or disabled worker equal to 50 percent of a retired spouse's primary insurance amount. Qualifying spouses must be at least age 62 or have a qualifying child (a child who is under the age of 16 or who receives Social Security disability benefits) in their care. Spousal benefits are reduced when the spouse takes benefits before the FRA, unless the spouse has a qualifying child in his or her care. Based on a FRA of 66, a spouse who claims benefits as early as age 62 may receive a benefit that is as little as 37.5 percent of the working spouse's PIA. Spousal benefits may also be reduced or fully offset by the dual entitlement provision or the government pension offset (described below) if the spouse is entitled to his/her own Social Security benefit based on work in covered employment or to a pension based on his or her own employment in certain federal, state or local government positions that are not covered by Social Security.

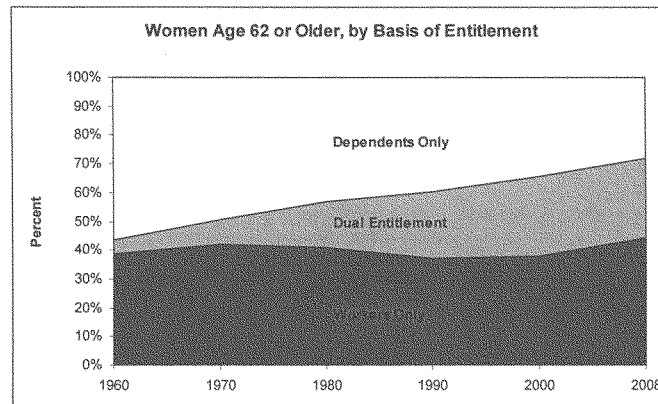
A monthly *survivor* benefit equal to 100 percent of the deceased worker's PIA is payable to a widow(er) or divorced spouse of a deceased worker who was fully insured at the time of

death. The surviving spouse must be age 60 (age 50 if disabled) and must not have remarried before age 60 (age 50 if disabled). As with spousal benefits, the surviving spouse's benefit may be reduced if he or she takes benefits before the FRA, or if the surviving spouse has a benefit from employment in certain federal, state or local government positions that are not covered by Social Security (see the discussion of the government pension offset, or GPO, below).

Some spouses and widow(er)s are entitled to benefits based on both their own earnings record and their spouse's earnings record. These workers are known as *dually-entitled* beneficiaries. A beneficiary who is dually entitled will receive his or her own worker benefit plus the difference between the worker benefit and his or her spouse's benefit. The total benefit may not be greater than the highest single benefit amount to which he or she is entitled.

Over time, more women have become entitled to Social Security benefits based on their own work records, either as workers or as dually-entitled workers, as shown in **Figure 1**. The number of women who were entitled to benefits based either on their own work records or as dually-entitled beneficiaries grew from 43 percent in 1960 to 72 percent in 2008. Within these numbers, however, most of the growth has been among dually-entitled beneficiaries. The percent of women who are entitled based solely on their own work records has fluctuated in a range between 39 percent and 44 percent between 1960 and 2008. Reliance on spousal benefits as a wife or widow, whether from dual entitlement or from spousal benefits alone, has fallen slightly over the past five decades, from 61 percent in 1960 to 56 percent in 2008.

FIGURE 1: BASIS OF ENTITLEMENT FOR WOMEN AGE 62 AND OLDER 1960-2008, SELECTED YEARS



Source: U.S. Social Security Administration, *Annual Statistical Supplement, 2009*, Washington, DC, table 5.A14, <http://www.ssa.gov/policy/docs/statcomps/supplement/2009/5a.html#table5.A14>.

Divorced spouses may qualify for spousal and/or survivor benefits if the marriage lasted at least 10 years before the divorce became final. To qualify for spousal benefits, a divorced spouse must be at least age 62 and not currently married. **Survivor benefits** are available to a divorced surviving spouse if he or she is age 60 or over (age 50 if disabled) and has not remarried before age 60 (age 50 if disabled). Divorced spouses who meet these criteria receive the same spousal and survivor benefits as spouses and widow(er)s. As with married and surviving spouses, a divorced spouse's benefit will be reduced if taken before the full retirement age, to offset a pension from non-covered federal, state or local government employment, or as a result of earnings above the retirement earnings test threshold. A dually-entitled divorced spouse (i.e., entitled to a benefit based on his or her own work record) will receive the higher of the spousal benefit or his or her own benefit. A divorced spouse may also become entitled on the worker's record if the worker has not yet filed for benefits, provided that the divorce has been in effect for at least 2 years and that both the worker and the divorced spouse are at least age 62.

A monthly benefit is payable to the **child** (including biological, adopted, step- child) of a retired, disabled, or deceased worker who was fully or currently insured at the time of death. The child must be either: (1) under age 18; or (2) a full-time elementary or secondary student under age 19; or (3) a disabled person age 18 or older whose disability began before age 22. Prior to May 1985, certain children in college were also eligible for the benefit.¹⁴ The child of a deceased worker is eligible for 75 percent of the worker's PIA, subject to the family maximum benefit, as described below. The child of a disabled or retired worker is eligible for 50 percent of the worker's PIA, subject to the family maximum benefit.

Social Security also provides a monthly **mother's or father's benefit** to a surviving parent of any age who cares for the deceased worker's child, when that child is either under the age of 16 or disabled. Mother's and father's benefits are 75 percent of the worker's basic benefit, subject to the maximum family benefit. These mother's or father's benefit payments cease when the youngest entitled child being cared for reaches age 16, is no longer disabled, or if the mother or father remarries.

A monthly survivor benefit is payable to a **parent** of a deceased fully insured worker if the parent is age 62 or older and has not married since the worker's death. The parent must have been receiving at least one-half of his or her support from the worker at the time of the worker's death or, if the worker had a period of disability which continued until death, at the beginning of the period of disability. Proof of support must be filed within 2 years after the worker's death or the month in which the worker filed for disability.

Total benefits payable to a family based on a retired or deceased worker's record are capped by the **maximum family benefit**. The maximum family benefit varies from 150 percent to 188 percent of the retired or deceased worker's PIA, and a family's total benefit cannot be

¹⁴ Before May 1985, student's benefits were payable to certain postsecondary students aged 18-22. P.L. 97-35, The Omnibus Budget Reconciliation Act of 1981, phased out by May 1985 the child's benefit for students in postsecondary schools age 18 and older, except for full-time, unmarried elementary or secondary school students between ages 18 and 19 (known as a "student's" benefit). Student's benefits end at age 19 or at the end of the current semester or quarter, whichever is later.

exceeded regardless of the number of recipients entitled on that earnings record. If the total individual monthly benefits payable to all recipients entitled on one earnings record exceeds the maximum, each dependent's or survivor's benefit is reduced in equal proportion to bring the total within the maximum. For the family of a worker who turns 62 or dies in 2010 before reaching age 62, the total amount of benefits payable is limited to:

- 150 percent of the first \$972 of PIA, plus
- 272 percent of PIA over \$972 through \$1,403, plus
- 134 percent of PIA over \$1,403 through \$1,830, plus
- 175 percent of PIA over \$1,830.

The dollar amounts in this benefit formula are indexed to average wage growth, as in the primary benefit formula.

For the family of a worker who is entitled to disability benefits, the maximum family benefit is the lesser of 85 percent of the worker's AIME or 150 percent of the worker's PIA. However, the family benefit cannot be lower than 100 percent of the worker's PIA.

Table 6 summarizes Social Security's auxiliary benefits to the spouses, divorced spouses, children and parents of a retired, disabled or deceased worker. As will be discussed below, the basic benefit may be reduced (or increased) for retirement below (or above) the full retirement age, for earnings above certain thresholds, for family maximums, and/or for receipt of a pension from work that was not covered by Social Security.

TABLE 6: SOCIAL SECURITY AUXILIARY BENEFITS

Basis for Entitlement	Eligibility	Basic Benefit Amount Before Any Adjustments
Spouse	At least age 62 The worker on whose record benefits are based must be receiving benefits.	50 percent of worker's PIA
Divorced Spouse <i>(if divorced individual was married to the worker for at least 10 years before the divorce became final and is currently unmarried)</i>	At least age 62 Generally, the worker on whose record benefits are based must be receiving benefits. However, a divorced spouse may receive benefits on the worker's record if the worker is eligible for (but not receiving) benefits and the divorce has been final for at least 2 years.	50 percent of worker's PIA
Widow(er) & Divorced	At least age 60	100 percent of worker's

Basis for Entitlement	Eligibility	Basic Benefit Amount Before Any Adjustments
Widow(er) <i>(if divorced individual was married to the worker for at least 10 years before the divorce became final and did not remarry before age 60)</i>		PIA
Disabled Widow(er) & Divorced Disabled Widow(er) <i>(if divorced individual was married to the worker for at least 10 years before the divorce became final and did not remarry before age 50)</i>	At least age 50 The qualifying disability must have occurred: (1) before or within 7 years of the worker's death; (2) within 7 years of having been previously entitled to benefits on the worker's record as a widow(er) with a child in his/her care; or (3) within 7 years of having been previously entitled to benefits as a disabled widow(er) that ended because the qualifying disability ended (whichever is later).*	100 percent of worker's PIA
Mothers and Fathers	Surviving parent of any age who cares for the deceased worker's child, when that child is either under the age of 16 or disabled. Eligibility generally ceases if the surviving mother or father remarries.	75 percent of the deceased worker's primary insurance amount (subject to the family maximum benefit*)
Parents	At least age 62 or older and has not married since the worker's death. The parent must have been receiving at least one-half of his or her support from the worker at the time of the worker's death or, if the worker had a period of disability which continued until death, at the beginning of the period of disability.	82.5 percent of the deceased worker's PIA if only one parent is entitled to benefits. If two parents are entitled to benefits, then each parent receives 75 percent of the deceased worker's PIA. Subject to the family maximum benefit.

Basis for Entitlement	Eligibility	Basic Benefit Amount Before Any Adjustments
Child	Children, including adopted, step-, or unmarried biological child of a retired, disabled, or deceased worker who was fully or currently insured at the time of death. The child must be either: (1) under age 18; (2) a full-time elementary or secondary student under age 19; or (3) a disabled person age 18 or older whose disability began before age 22.	75 percent of the deceased worker's primary insurance amount to children of deceased workers (subject to the family maximum benefit*) 50 percent of the worker's primary insurance amount to children of disabled or retired workers (subject to the family maximum benefit*)

For a full description of Social Security eligibility, see <http://www.socialsecurity.gov/retire2/yourspouse.htm> and <http://www.socialsecurity.gov/ww&os2.htm>.

* The maximum family benefit varies from 150 percent to 188 percent of a retired or deceased worker's PIA. For the family of a worker who is entitled to disability benefits, the maximum family benefit is the lesser of 85 percent of the worker's AIME or 150 percent of the worker's PIA, but no less than 100 percent of the worker's PIA. It does not apply with respect to a divorced spouse or surviving spouse's benefits.

Social Security benefits are not particularly generous. **Table 7** shows the number of Social Security beneficiaries in 2008 as well as average monthly benefits by gender. In 2008, the average monthly retirement benefit was \$1,299 for men (\$15,588 per year) and \$1,001 for women (\$12,012 per year). Spouses, who receive half of the worker's benefits, received on average \$556 per month for women (\$6,672 per year) and \$324 for men (\$3,888 per year). Widows received, on average, \$1,115 per month (\$13,380 per year) and widowers received \$938 (\$11,256 per year).

Since Social Security benefit levels are based on contributions up to the taxable maximum, benefits for even high earners are relatively modest. In 2010, the maximum Social Security retirement benefit that could be received would be \$1,824 per month (\$21,888 per year) if someone retired at the early eligibility age of 62, and \$2,346 per month (\$28,152 per year) if they retired at the full retirement age of 66. However, to receive this level of benefits, someone would have to earn the taxable maximum or more for at least 35 years of their career, which almost never occurs.

TABLE 7: NUMBER AND AVERAGE MONTHLY BENEFIT IN DECEMBER 2008 BY BENEFIT TYPE AND GENDER

	Number (in thousands)	Average Monthly Benefit
<i>Retired Workers</i>		

	Number (in thousands)	Average Monthly Benefit
Men	16,455.8	\$1,299
Women	15,817.8	\$1,001
Disabled Workers		
Men	3,924.5	\$1,191
Women	3,502.2	\$920
Spouses		
Wives	2,472.3	\$556
Husbands	52.6	\$324
Widowed Mothers and Fathers		
Women	149.2	\$843
Men	10.4	\$720
Nondisabled Widow(er)s		
Women	4,094.9	\$1,115
Men	55.3	\$938
Disabled Widow(er)s		
Women	220.3	\$692
Men	9.7	\$498
Parents		
Women	1.5	\$988
Men	0.2	\$910

Source: Social Security Administration, *Annual Statistical Supplement, 2009*, Washington, DC, tables 5.A1.1, 5.A1.2, 5.A1.3, 5.A1.5, 5.A1.6, 5.A1.7 and 5.A1.8, <http://www.socialsecurity.gov/policy/docs/statcomps/supplement/2009/5a.html#table5.a1.5>.

Benefit Adjustments for Retirement Before or After the Full Retirement Age

For persons claiming benefits before (or after) their full retirement age (FRA), the monthly benefit amount is decreased (or increased) by an adjustment that is roughly actuarially fair. The actuarial adjustment ensures that, on average, an individual will receive the same total benefits over his or her expected lifetime, but the monthly benefit will be reduced (or increased) to account for the greater (or fewer) number of months that the person is expected to receive benefits.¹⁵ For persons with an FRA of 65 (i.e. somebody who was born in 1938 or earlier), collecting benefits upon turning 62 would entail a 20 percent cut in PIA. For a person with an FRA of 67, the decision to start collecting benefits upon turning 62 would result in a 30 percent cut to PIA. Benefits of workers who choose to retire after their FRA are increased by *delayed retirement credits*.

¹⁵ Retirement benefits are reduced by 5/9 of one percent (or 0.0056) of the primary earner's benefit for each month of entitlement before FRA, for a reduction of about 6.7 percent a year, up to 36 months. For each month of retirement in excess of 36 months for which the worker is below the FRA, retirement benefits are reduced by 5/12 of one percent (or 0.0042), for a reduction of 5 percent a year. Starting in 1990, the delayed retirement credit increased by .5 percent every other year until it reached 8 percent for workers who reached age 65 after 2007. See Table 1-26 on page 1-60 of "Background Material and Data on Programs within the Jurisdiction of the Committee on Ways and Means, 2004," The Green Book. House Ways and Means Committee Print, Washington, DC: Government Printing Office, available at <http://waysandmeans.house.gov/media/pdf/111/ssgb.pdf>.

Benefit Adjustments for the Government Pension Offset (GPO) and Windfall Elimination Provision (WEP)

Two provisions reduce the Social Security benefits of workers and their spouses who may have pensions from employment that was not covered by Social Security.

The *windfall elimination provision* reduces the benefit of workers who have pensions from work that was not covered by Social Security. The WEP is intended to remove an unintentional advantage for workers who have a pension from non-covered work in addition to qualifying for Social Security benefits. Before the WEP was introduced, workers who had short careers in Social Security-covered jobs received an unintended “windfall” because the Social Security formula recorded the many years in jobs not covered by Social Security as years of “zero” earnings. This made the employee appear to have had low lifetime earnings, and the worker benefited from the Social Security benefit formula’s progressivity which is intended for workers who have had long careers at low wages.

The *government pension offset* reduces Social Security spousal and survivor benefits that would be payable to spouses who also receive a public pension as a result of his or her own work in a government job (Federal, State, or local) not covered by Social Security. The amount of the reduction is equal to two-thirds of the government pension. This provision is intended to parallel the Social Security “dual entitlement” rule (discussed above), which imposes a dollar-for-dollar offset of spouses’ Social Security retirement benefits.

Benefit Adjustments for the Retirement Earnings Test

Social Security beneficiaries who are under the full retirement age and continue to work and have earnings above a threshold have their current benefits reduced and their future benefits increased. The retirement earnings test reduces benefits for workers under the FRA (age 67 for workers born in 1960 or later) who earn income from work in excess of an “exempt” amount. The exempt amount in 2010 is \$14,160 in annual wages or self-employment income. Beneficiaries with earnings above this amount, who are also below the FRA, experience a benefit reduction of \$1 of benefits for each \$2 of earnings above the exempt amount.¹⁶

The retirement earnings test does not apply to pensions, rents, dividends, interest, and other types of “unearned” income. The test also does not apply to beneficiaries at the FRA or older, or to those who are disabled (disabled recipients are subject to separate limits on earnings known as substantial gainful activity amounts). The exempt amounts rise each year at the same rate as average wages in the economy.

Retired workers whose benefits are reduced by the retirement earnings test are compensated, once they retire, through increases in their benefit amount. The following example

¹⁶ A different reduction factor and exempt amount apply in the year beneficiaries attain the FRA. In 2010, these individuals can earn up to \$37,680 a year in the months before they attain the FRA. For earnings above these amounts, the RET results in a reduction of \$1 in benefits for each \$3 of excess earnings.

illustrates the effect of the retirement earnings test. The example worker is age 63 and has \$12,000 in annual benefits before the test is applied:

Retirement Earnings Test, 2010	
Earnings in 2010	\$15,160
Exempt amount in 2010 for persons under FRA	\$14,160
Excess over exempt amount	\$1,000
Benefit reduction (50 percent of excess)	\$500
Annual Benefits the worker will receive	\$11,500

The rationale for the retirement earnings test was described in the 1935 report of the Committee on Economic Security, which recommended that no benefits be paid before a person had “retired from gainful employment.” The retirement earnings test has been changed many times over the years.

Table 8 illustrates the number of retired workers by full retirement age (FRA), as affected by the Social Security Retirement Earnings Test (RET) in 2006, the latest year for which data are available.

TABLE 8: NUMBER OF RETIRED WORKERS WITH EARNINGS, BY FULL RETIREMENT AGE (FRA), 2006

Earnings	Younger Than FRA for All of 2006	Attains FRA in 2006
\$1 - 4,999	356,000	117,500
5,000 – 9,999	226,500	69,900
10,000 - 14,999	213,500	60,900
15,000 - 19,999	72,800	35,800
20,000 - 24,999	39,200	17,100
25,000 - 29,999	17,600	9,700
30,000 - 34,999	10,200	7,800
35,000 - 39,999	6,300	6,000
40,000 - 44,999	5,600	2,100
45,000 - 49,999	3,600	1,700
50,000 - 54,999	2,500	1,500
55,000 - 59,999	2,100	1,300
60,000 - 64,999	1,800	700
65,000 - 69,999	1,300	800

Earnings	Younger Than FRA for All of 2006	Attains FRA in 2006
70,000 - 74,999	1,300	500
75,000 - 79,999	1,000	700
80,000 - 84,999	800	600
85,000 - 89,999	900	400
90,000 - 99,999	900	800
100,000 or more	5,400	3,100
Total with Earnings	969,300	338,900

Sources: Office of Research, Evaluation and Statistics, Social Security Administration: 2007, 1 Percent Continuous Work History Sample and 2006 Employee and Employer File.

Special Minimum Benefit

The special minimum PIA is payable to some persons who worked in covered employment for many years but had low earnings. Unlike the retired worker's PIA described above, which is based on a worker's average earnings, the special minimum is based on the number of years of covered employment at a specified level of substantial earnings. The amount of the special minimum is determined by multiplying the number of years of substantial earnings in excess of 10 years and up to 30 years by \$11.50 for monthly benefits payable in 1979. Parameters used to determine the special minimum benefit are indexed to price inflation.

A worker is awarded the special minimum benefit only if it exceeds the worker's regular benefit. However, the value of the special minimum benefit, which is indexed to prices, is rising more slowly than the value of the regular Social Security benefit, which is indexed to wages. Therefore, the number of beneficiaries of the special minimum benefit has declined with each year. In December 2008, there were 89,000 beneficiaries¹⁷ who received the special minimum benefit. One study predicted that the special minimum benefit will disappear for workers reaching age 62 in 2013 and later.¹⁸

How is the Social Security Program Financed?

The Social Security program is financed through three sources of funds. These sources are: (1) payroll taxes collected under the Federal Insurance Contributions Act (FICA) and the

¹⁷ *Annual Statistical Supplement to the Social Security Bulletin, 2009*, Table 5.A.8, available at <http://www.socialsecurity.gov/policy/docs/statcomps/supplement/2009/5a.html#table5.a8>

¹⁸ Kelly A. Olsen and Don Hoffmeyer, "Social Security's Special Minimum Benefit," *Social Security Bulletin*, vol. 64, no. 2 (2002), p. 6, available at <http://www.ssa.gov/policy/docs/ssb/v64n2/v64n2p1.pdf>.

Self Employment Contributions Act (SECA); (2) federal income taxes on the benefits of certain beneficiaries; and (3) interest on special U.S. government obligations held by the Trust Funds.

Payroll Taxes

Payroll taxes (i.e., social-insurance contributions as stipulated by the Federal Insurance Contributions Act (FICA) and Self-Employment Contributions Act (SECA)) are levied on the wages and net self-employment income of workers covered by Social Security. The FICA tax is levied at a rate of 15.3 percent, with employees and their employers each paying half of the total amount. Of the total 15.3 percent FICA tax, 12.4 percent is used to finance the Social Security program, and 2.9 percent is used to finance the Medicare program. The Social Security portion of the tax is levied on earnings up to \$106,800 in 2010.¹⁹ The Medicare portion of the tax is levied on all earnings.

The SECA tax also is levied at a rate of 15.3 percent, with the same 12.4 percent and 2.9 percent split between Social Security and Medicare as the FICA tax. However, to reflect the fact that employees do not pay FICA taxes on the employer's portion of the FICA tax, the taxable base for the SECA tax is adjusted downward by 7.65 percent and self-employed workers are allowed to deduct half of their SECA tax liability for income tax purposes.

Table 9 and Table 10 show FICA and SECA tax rates and maximum taxable earnings for 1937-2010, respectively.

**TABLE 9: FICA TAX RATES, AVERAGE WAGE INDEX, AND
MAXIMUM TAXABLE EARNINGS, SELECTED YEARS 1937-2010**

[in percent]							
Calendar year	Rate paid by employee and employer					Average wage index	Maximum taxable earnings ¹
	OASI	Disability insurance (DI)	OASD I	Hospital insurance (HI)	Total		
1937	1.00	NA	NA	NA	1.00	\$1,138	\$3,000
1950	1.50	NA	NA	NA	1.50	2,544	3,000
1960	2.75	0.25	3.00	NA	3.00	4,007	4,800
1970	2.75	0.55	4.20	0.60	3.65	6,186	7,800
1980	4.52	0.56	5.08	1.05	6.13	12,513	25,900
1990	5.60	0.60	6.20	1.45	7.65	21,028	51,300
1995	5.26	0.94	6.20	1.45	7.65	24,706	61,200
2000	5.30	0.90	6.20	1.45	7.65	32,155	76,200
2005	5.30	0.90	6.20	1.45	7.65	36,953	90,000

¹⁹ The "taxable wage base" increases annually with average wage growth in the economy.

2008	5.30	0.90	6.20	1.45	7.65	41,335	102,000
2009	5.30	0.90	6.20	1.45	7.65	*	106,800
2010	5.30	0.90	6.20	1.45	7.65	*	106,800

¹OASDI; no limit on HI.

NA- Not applicable.

* - Not available.

Note- Until 1991, the maximum taxable earnings for HI were the same as for OASDI. In 1991, 1992, and 1993 maximum taxable earnings were \$125,000, \$130,200, and \$135,000 respectively, with no limit after 1993. Only 92.35 percent net self-employment earnings are taxable and half of the SECA taxes so computed is deductible for income tax purposes.

Source: Social Security Administration.

**TABLE 10: OASDI AND HI TAX RATES FOR SELF-EMPLOYED
INDIVIDUALS, 1980-2010**
[in percent]

Calendar year	OASI	DI	OASDI	HI	Total (OASDI and HI)
1980	6.2725	0.7775	7.05	1.05	8.10
1981	7.0250	0.9750	8.00	1.30	9.30
1982	6.8125	1.2375	8.05	1.30	9.35
1983	7.1125	0.9375	8.05	1.30	9.35
1984	10.4000	1.0000	11.40	2.60	14.00 ¹
1985	10.4000	1.0000	11.40	2.70	14.10 ¹
1986-1987	10.4000	1.0000	11.40	2.90	14.30 ¹
1988-1989	11.0600	1.0600	12.12	2.90	15.02 ¹
1990-1993	11.2000	1.2000	12.40	2.90	15.30
1994-1996	10.5200	1.8800	12.40	2.90	15.30
1997-1999	10.7000	1.7000	12.40	2.90	15.30
2000 and later	10.6000	1.8000	12.40	2.90	15.30

¹ Tax credits for the self-employed equaled 2.7 percent in 1984, 2.3 percent in 1985, and 2.0 percent in 1986-1989. The tax rate is not reduced for these credits

Source: Social Security Administration.

Taxation of Benefits

Social Security beneficiaries with incomes²⁰ above certain thresholds are required to include a portion of their Social Security benefits in their federal taxable income. The Social Security Amendments of 1983 required beneficiaries with incomes of more than \$25,000 if single, and \$32,000 if married filing jointly,²¹ to include up to 50 percent of their benefits in taxable income, beginning in 1984. Revenues from taxing up to 50 percent of Social Security benefits are credited to the Social Security Trust Funds. The Omnibus Budget Reconciliation Act of 1993 required beneficiaries with modified incomes of more than \$34,000 if single, and

²⁰ Income is defined as adjusted gross income plus tax-exempt bond interest plus one-half of Social Security benefits.

²¹ There is no separate threshold for married persons who live together and file separately.

\$44,000 if married filing jointly, to include up to 85 percent of their benefits in their taxable income, beginning in 1994. Revenues from taxing 51 percent to 85 percent of Social Security benefits are credited to the Medicare Hospital Insurance Trust Fund. These income thresholds are specified in the law and by design are not indexed. Thus over time, an increasing number of individuals will be subject to federal income tax on a portion of Social Security benefits. When taxes on benefits were first imposed, eight percent of recipients were affected. The Congressional Budget Office (CBO) estimates that for tax year 2005, 39 percent of recipients were affected.

Interest on Special U.S. Obligation Bonds

The Social Security Trust Funds earn interest because it holds Special US Obligation Treasury Bonds to which it is legally entitled interest, as prescribed in the Social Security Act: “Special issues ... will pay a rate of interest equal to the average market yield on all marketable interest-bearing obligations of the United States which are not due or callable (redeemable) for at least 4 years.” The interest on the special U.S. obligations thus is equal to the prevailing average rate on outstanding Federal securities with a maturity of four years or longer. This interest is credited to the Trust Funds twice a year (on June 30 and December 31) by issuing more special securities to the Trust Funds.

The Social Security Trust Funds

Social Security is funded through dedicated payroll taxes and taxation of benefits which legally may only be used to pay current benefits or to invest in a Social Security Trust Fund reserve for payment of future benefits. The securities issued to the Trust Funds, like those sold to the public, are legal obligations of the U.S. Government.

Technically, there are two separate Trust Funds: the Old-Age and Survivors Insurance (OASI) Trust Fund, which holds in trust those funds that the federal government intends to use to pay future benefits to retirees and their survivors; and, the Disability Insurance (DI) Trust Fund, which holds in trust those funds that the federal government intends to use to pay benefits to those who are judged by the federal government to be disabled and incapable of productive work, as well as to their spouses and dependents.

To the extent that payroll taxes exceed benefit payouts in a given year, participants in the Social Security program are in effect saving for their future retirement, disability or survivor benefit needs, or for those of other participants in the program. These pre-funded amounts earn interest, which accrues to the Trust Funds. In 2008, the Trust Fund’s assets earned interest at an effective annual rate of 5.1 percent.²²

The long-range status of the Trust Funds is often expressed in terms of percent of taxable payroll rather than in dollar amounts. This permits a direct comparison between the tax rate in the law and the cost of the program. For example, if the program is projected to have a deficit of two percent of taxable payroll as it was in 2009, the OASDI tax rates now in the law would have to be increased by one percentage point each for employee and employer (a total of two percent) in order to pay for the benefits due. Alternatively, the program could be brought back into

²² 2009 Social Security Trustees’ Report, available at http://www.ssa.gov/OACT/TR/2009/II_cyoper.html#94983.

balance by an equivalent reduction in benefits. For example, if the program is projected to have a deficit of two percent of taxable payroll, and expenditures are projected to be 10 percent of taxable payroll, then a 20 percent (2 divided by 10) reduction in benefits would be needed to bring the program into long-range fiscal balance. Finally, fiscal balance could also be met through a combination of revenue increases and benefit reductions.

Historical Status of the Trust Funds

For more than three decades after Social Security taxes were first levied in 1937, the system's income routinely exceeded its outgo, and its Trust Funds grew. The situation changed, however, in the early 1970s.

Beginning in 1973, the program's income fell below expenditures, and the Trust Funds declined rapidly. Congress stepped in five times during the late 1970s and early 1980s to keep the Trust Funds from being exhausted. Although major changes enacted in 1977 greatly reduced the program's long-run deficit, they did not eliminate it, and the short-run changes made by the legislation were not sufficient to enable the program to withstand back-to-back recessions in 1980 and 1982, coupled with high inflation and low wage growth. A Social Security disability bill in 1980 and temporary fixes in 1980 and 1981 were followed by another major reform package in 1983. The 1983 changes, along with improved economic conditions, dramatically improved the short- and long-range fiscal outlook for Social Security. Income began to exceed outgo in 1983 and the Trust Funds grew substantially. By the end of calendar year 2008, the balance in the Trust Funds reached \$2.4 trillion, an amount equivalent to 354 percent of expenditures in 2008 (between three and four years' worth of benefits).

Social Security and the Federal Budget

By law, the receipts and disbursements of the Social Security Trust Funds are excluded from the President's budget and the Congressional budget resolution (in other words, the Trust Funds are "off-budget"). The off-budget status of the Social Security Trust Funds has meant that legislation affecting the receipts and disbursements of the Trust Funds is excluded from the general budget constraints associated with the annual Congressional budget resolution, resulting in the need for separate rules to ensure that legislation considered by Congress does not negatively affect the Social Security Trust Funds balances. For example, Social Security is prohibited from borrowing funds, going into debt, and contributing to the federal deficit. Social Security will only pay benefits if it has the dedicated funds. Social Security's monies are kept in a trust apart from the general fund, and the Budget Act expressly prohibits changes made to Social Security as part of any budget reconciliation process (see Appendix for House and Senate Procedures that protect Social Security balances).

Legacy Costs

In initial years of Social Security, retirees received benefits that far exceeded the value of contributions that they and their employers had been able to make in the short time Social Security had been operational. Social Security contributions were first collected from workers

and employers in 1937 and benefits were first paid in 1940. This created a deficit of contributions or “*legacy cost*”. Some people advocate for a revenue source outside current workers payroll to pay for this legacy cost. Economists have estimated that Social Security’s legacy cost is roughly \$13 trillion.²³

The Annual Report of the Board of Trustees

The Social Security Act requires that the Board of Trustees²⁴ report to the Congress annually on the financial status of the Social Security Trust Funds. The Social Security Trustees report short-range (10-year) projections and long-range (75-year) projections of the financial status of the Social Security system. Projections are made separately for each of the two Social Security Trust Funds (the Old-Age and Survivors Insurance (OASI) Trust Fund and the Disability Insurance (DI) Trust Fund) and for the Trust Fund on a combined basis (the OASDI Trust Fund).

Because the Social Security program is designed as a contributory system in which workers who pay payroll taxes to support the system are considered to be earning the right to future benefits, Congress has traditionally required long-range estimates of the program’s actuarial balance. Under current procedures, the traditional long-range actuarial analysis of the program covers a 75-year period, which generally would be sufficient to cover the anticipated retirement years of persons currently in the work force.

The long-range projections are affected by three types of factors: (1) demographic factors, such as rates of fertility, life expectancy, and immigration, which determine the number of workers in relation to recipients; (2) economic factors, such as unemployment, productivity, interest rates and inflation; and (3) factors specifically related to the Social Security program, such as eligibility rules, benefit levels, and the categories of covered employment.

Given the uncertainty surrounding the long-range projections, the actuaries at the Social Security Administration (SSA) employ three sets of alternative economic and demographic assumptions: Alternative I, based on optimistic assumptions; Alternative II, based on intermediate assumptions; and Alternative III, based on pessimistic assumptions. Alternative II generally is considered the “best guess” of long-term solvency and is the most frequently cited.

Findings in the 2009 Trustees Report

The latest report of the Social Security Board of Trustees was released on May 12, 2009.²⁵ Projections²⁶ show the Old Age, Survivors, and Disability Insurance program will

²³ Munnell, Alicia H., “Should Social Security Rely Solely on the Payroll Tax?,” Center for Retirement Research at Boston College, Brief Number 9-16, Boston, MA: Center for Retirement Research, 2009, available at http://crr.bc.edu/briefs/should_social_security_rely_solely_on_the_payroll_tax_html.

²⁴ The Board of Trustees is comprised of the Secretary of Treasury (who is the Managing Trustee), the Secretary of Labor, Health and Human Services, the Commissioner of Social Security and two representatives of the public.

²⁵ 2009 Social Security Trustees’ Report, available at <http://www.ssa.gov/OACT/TR/2009/tr09.pdf>

continue to add tax revenue to their Trust Funds up to 2016. The Trust Funds will continue to grow because of interest earned through 2023. After 2023, the Trust Funds' assets will begin to be tapped to help pay for the retirement of the unusually large baby boomer cohort. By 2037, the reserves are expected to be exhausted, and current revenues will only be sufficient to finance 76 percent of benefits.²⁷

On average, over the next 75 years (2009-2083), the system's projected actuarial deficit is 2.00 percent of taxable payroll. In present value terms, over the next 75 years the system's projected unfunded obligation is \$5.3 trillion, an amount equivalent to 0.7 percent of Gross Domestic Product (GDP). In the 75th year of the period, the cost of the system is projected to exceed income by 4.34 percent of taxable payroll.

Social Security has always been structured primarily as a pay-as-you-go system, with current benefits mostly funded out of current tax revenues. However, Social Security is currently running a surplus. In 2009, an estimated 94 percent of Social Security tax revenues were spent to meet current expenditures (benefits and administrative costs). The surplus tax revenues, along with interest credited to the Trust Fund, contribute to a growing Trust Fund balance. For OASDI, interest income will first be needed to pay a portion of benefits in 2016, although the Trust Fund will continue to accumulate assets until around 2025, when Social Security begins drawing down the Trust Fund.

Long-range projections for the Social Security Trust Fund are based on many demographic, economic, and program-specific factors. In large part, however, the system's projected long-range funding shortfall is related to demographic changes in the United States. According to the Social Security actuaries, lower birth rates are the principal reason that the cost of the Social Security program will increase over the next quarter century. The "total fertility rate," or the average number of children women have, was about 3.3 children per woman during the baby boom years from 1946 through 1965. By 1972, however, the total fertility rate dropped to two children per woman and has stayed at about that level ever since.

Moreover, the first wave of the 80 million member baby boom generation reached age 62 in 2008, the age at which reduced Social Security retirement benefits are first payable. In addition, projected increases in life expectancy will contribute to an older society. The Trustees' intermediate assumptions project that, between 2010 and 2030, the number of beneficiaries will increase by 59 percent, while the number of workers whose taxes will finance future benefits will increase by 14 percent. As a result, the number of workers supporting each Social Security recipient is projected to decline from 3.0 today to 2.2 in 2030. After the baby boomer retirement, however, the ratio is projected to stabilize at approximately two, with only a very gradual decline due to projected increases in life expectancy.

²⁶ The 2009 Social Security Trustees' Report, Table VI.F7, available at <http://www.ssa.gov/OACT/TR/2009/tr6f8.html>.

²⁷ The term "exhausted" is commonly used to indicate that the Trust Fund balance plus payroll taxes and other revenues would be insufficient to pay all benefits when they are due.

An increase in older Americans participating in the workforce can increase the solvency of Social Security.²⁸ The 65-and-over labor force participation rate had been at historic lows during the 1980s and early 1990s, but has increased steadily over the past decade. In 2008, 20.5 percent of men over the age of 65 and 11.9 percent of women over 65 were in the labor force, for a total workforce participation of 15.5 percent.

The aging of the U.S. population will continue to be an important factor after the baby boomers have died. Forecasts of continuing increases in life expectancy mean that Social Security recipients will receive benefits for longer periods in the future. Projected increases in life expectancy and low fertility rates, mean that persons age 67 and older will continue to represent a growing share of the U.S. population.

The long-range intermediate projections assume that GDP will increase at an ultimate rate of 2.1 percent annually; the average wage is assumed to increase at an ultimate rate of 3.9 percent annually; inflation is assumed to increase at an ultimate rate of 2.8 percent annually; and the unemployment rate is assumed to average 5.5 percent.²⁹ Details on the demographic assumptions are available in the 2009 Trustees report. The 2010 Trustees report, which will be issued in June of this year, will likely have different estimates of the Trust Funds' solvency due to the impact of the economic downturn in reducing revenues and increasing the number of new beneficiaries.

The Congressional Budget Office Forecast

The Congressional Budget Office (CBO) generates projections of the Social Security Trust Funds independent of the Social Security Trustees. In January 2010,³⁰ the CBO projected that, excluding the interest from its surplus, the Social Security Trust Funds will have a cash flow deficit (income excluding interest will be less than outlays) in fiscal years 2010 through 2013 and in fiscal years 2016 through 2020. CBO projects that only in fiscal years 2014 and 2015 will the Social Security Trust Funds have a cash flow surplus (income excluding interest will be greater than outlays).

When total income of the Trust Funds (Social Security tax revenues plus interest income) is taken into account, CBO projects that the Social Security Trust Funds will have a surplus in each fiscal year from 2010 to 2020. When the Social Security Trust Funds operate with a cash flow deficit, a portion of the U.S. government bonds held by the Trust Funds must be redeemed to cover benefit payments and administrative costs. The money needed to redeem these bonds, like all Treasury bonds, comes from the U.S. Treasury's general fund.

²⁸ Bureau of Labor Statistics, "Older Workers," July 2008, available at http://www.bls.gov/spotlight/2008/older_workers/

²⁹ Ultimate values are assumed to be reached within the first 25 years of the projection period. The ultimate economic assumptions are unchanged from the 2007 report.

³⁰ Congressional Budget Office, *The Budget and Economic Outlook: Fiscal Years 2010 to 2020*, January 2010, available at: <http://www.cbo.gov/ftpdocs/108xx/doc10871/01-26-Outlook.pdf>. In addition, see the CBO supplemental data table, available at <http://www.cbo.gov/budget/factsheets/2010/oasdi.pdf>.

CBO attributes the increase in outlays between fiscal years 2010 and 2020 to three factors: (1) an increase in those claiming benefits; (2) changes in benefits including the effect of projected wage growth on benefit levels for future retirees; and (3) automatic cost-of-living adjustments to benefits. In the CBO forecast, almost half of the change in spending (48.2 percent) between fiscal years 2010 and 2020 is due to an increase in the number of people claiming benefits. This increase³¹ is due both to the rise in the number of people eligible for benefits and the economic downturn, which increased the unemployment rate for workers aged 62-64 from 3.9 percent in 2008 to 6.2 percent in 2009.³²

Who Receives Benefits from Social Security?

In June, 2009, 51.9 million people—17 percent of the U.S. population—received Social Security benefits. Social Security is an important source of retirement income, but it also protects workers and their families against the loss of income that occurs due to a worker's death or disability. The majority of Social Security beneficiaries are retired workers, but more than one-third of persons who received Social Security benefits in 2009 qualified on the basis of disability or as the spouse, widow or widower, parent, or child of a retired, deceased, or disabled worker.

In June, 2009, 63.7 percent of Social Security beneficiaries (33.1 million people) were retired workers who had earned benefits on the basis of retirement from covered employment³³ (See **figure 2**). The next largest category of beneficiaries was disabled workers, comprising 14.6 percent of all beneficiaries. More than 7.5 million people received Social Security Disability

³¹ The Office of the Chief Actuary SSA estimated last year that, even in the absence of an economic recession, applications for retired worker benefits under the OASI program during FY 2009 would be about 15 percent higher than the number of applications during FY 2008, solely due to increase in numbers of insured workers reaching the retirement ages of 62 to 70. This increase was expected due to the aging of the baby boom and the increasing percentages of women reaching retirement ages having attained insured status enabling them to receive retired worker benefits.

The actual data for applications for retired worker benefits in FY 2009 (for October 2008 through September 2009) show an increase of 21 percent over the number of applications in FY 2008. Thus, retired worker benefit applications were about 5 percent higher (1.21/1.15) than had been expected in the absence of a recession for the entire fiscal year 2009.

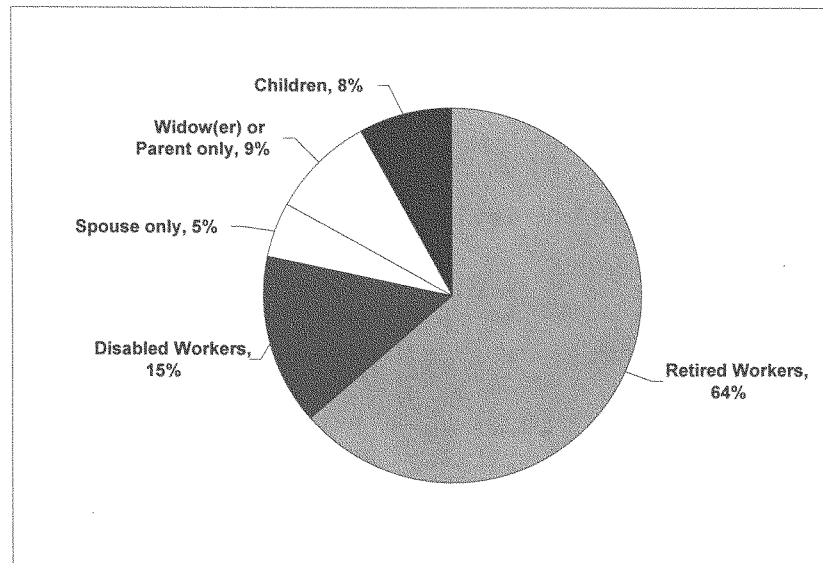
While retired worker benefit applications for FY 2009 were clearly above the levels expected in the absence of a recession, this does not mean that fewer workers of retirement age are working or seeking employment. In fact, based on data from the "household survey" published by the Bureau of Labor statistics, we see that the average number of people at ages 60 to 69 who were employed or seeking employment (in the civilian labor force) during FY 2009 (October 2008 through September 2009) was 7.1 percent higher than for the same months in FY 2008. In the 2008 Trustees Report, where no recession had been expected, an increase in the labor force at these ages of 4.5 percent had been expected for the same period. Thus, 2.5 percent more individuals at ages 60 to 69 were working or seeking employment in FY 2009 than had been expected without a recession. This rise might be, in part, a reflection of a desire of some older workers to work longer to rebuild the level of their personal retirement assets. (Stephen Goss, Chief Actuary of the Social Security Administration, 10/14/2009)

³² Labor Force Statistics from the Current Population Survey, provided by the Bureau of Labor Statistics on April 16, 2010.

³³ Some beneficiaries are "dually entitled" to benefits as both a retired worker and as the spouse of a retired or disabled worker. In Figure 2, dually-entitled beneficiaries are classified as retired workers.

Insurance (SSDI) in 2009. Widows and widowers of workers and retirees were 8.7 percent of all beneficiaries. More than 4.2 million people, comprising 8.1 percent of all Social Security beneficiaries, received children's benefits from Social Security in 2009. Most children qualified for Social Security because they were the dependents of retired, deceased, or disabled workers. About one-fifth of child beneficiaries were adults who had been disabled since childhood. Spouses of retired or disabled workers were 4.8 percent of all beneficiaries in 2009.

FIGURE 2: SOCIAL SECURITY BENEFICIARIES BY BASIS OF ELIGIBILITY, JUNE 2009



Note: Represents 51.9 million persons receiving Social Security benefits in June, 2009.

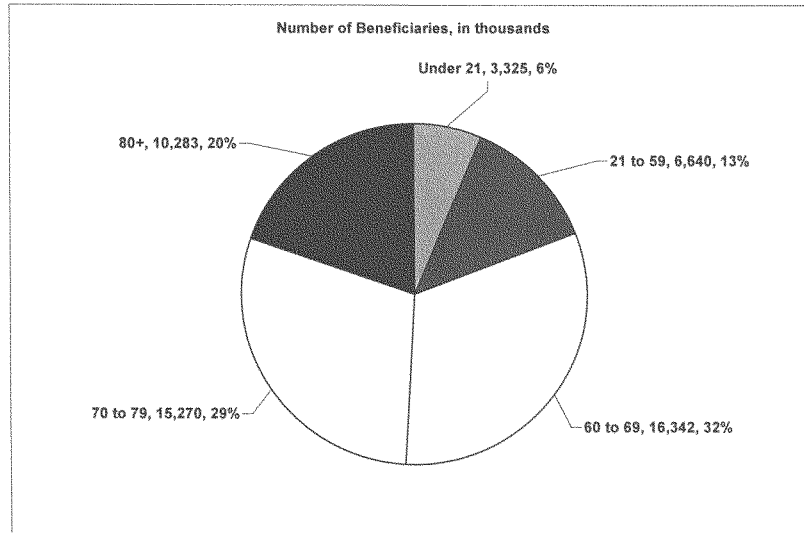
Source: CRS analysis of administrative data from the Office of the Actuary of the Social Security Administration.

Of the 51.9 million individuals who received Social Security benefits in June, 2009, 80.7 percent were aged 60 or older (See **figure 3**.) Almost one-third of all beneficiaries were 60 to 69 years old. This age group included disabled workers, retired workers, spouses, widows and widowers, and parents. Individuals who receive Social Security Disability Insurance are reclassified as retired workers at the full retirement age (66 in 2009). Retired-worker benefits are first available at age 62, but the benefit is permanently reduced for workers who claim it before they have reached the full retirement age. Widows and widowers are eligible for benefits at age 60. Disabled widows and widowers are eligible for Social Security at age 50.

Almost half of Social Security beneficiaries (49.2 percent) in June 2009 were aged 70 or older. Twenty-nine percent of beneficiaries were 70 to 79 years old and 20 percent were aged 80

and older. Social Security's role in providing income support to disabled workers and to the dependents of disabled and deceased workers is illustrated by the fact that 19.2 percent of beneficiaries in 2009 were children under the age of 21 or adults under age 60. Together, these two age groups accounted for nearly 10 million of the 51.9 million people who received Social Security benefits in 2009.

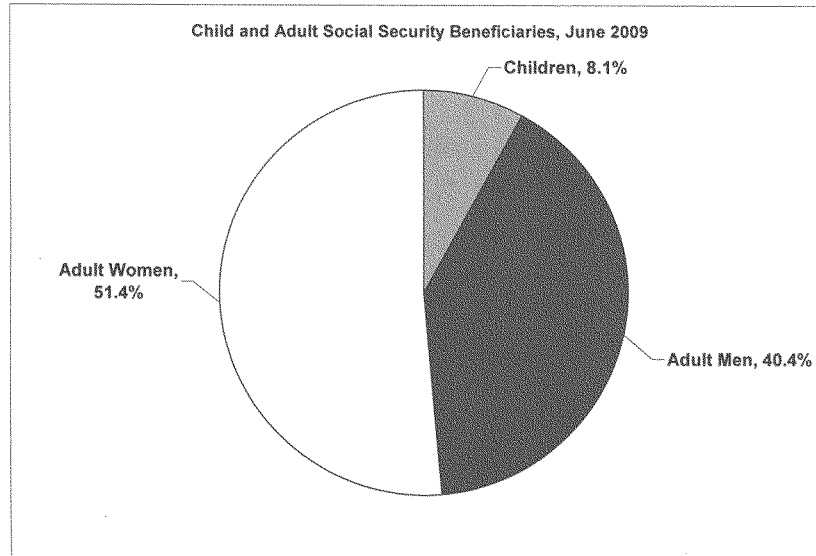
FIGURE 3: SOCIAL SECURITY BENEFICIARIES BY AGE, JUNE 2009



Note: Represents 51.9 million persons receiving Social Security benefits in June, 2009.

Source: CRS analysis of administrative data from the Office of the Actuary of the Social Security Administration.

More than half of all Social Security beneficiaries in 2009 were women (see **figure 4**). Forty percent of beneficiaries were men and eight percent were children, including adults whose disability had been present since childhood. Women are the majority of adult Social Security beneficiaries in part because they have a longer average life expectancy than men. Men are a slight majority of disabled worker beneficiaries (53 percent in 2009), but this is more than offset by the higher mortality rates among men at all ages compared to women. Because of their longer average life expectancy, 57 percent of all Social Security beneficiaries aged 60 and older were women in 2009, as were 64 percent of all beneficiaries aged 80 and older.

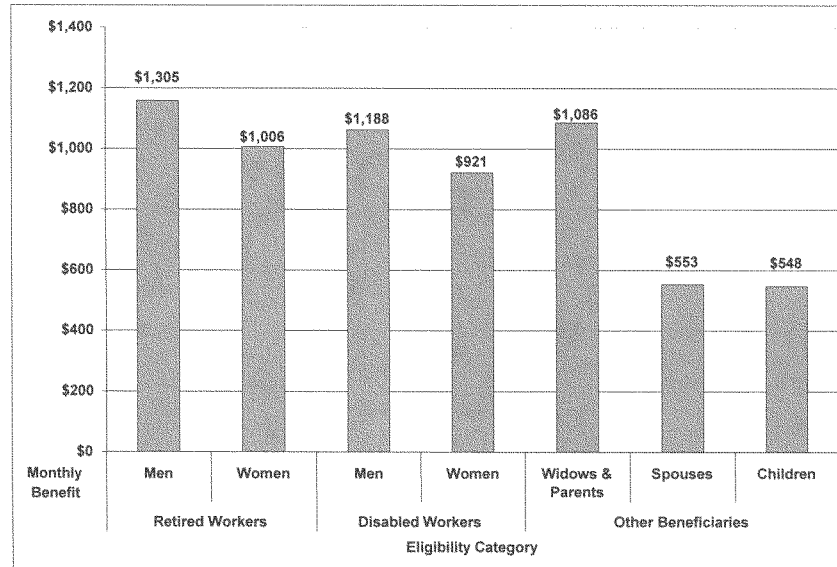
FIGURE 4: CHILD AND ADULT SOCIAL SECURITY BENEFICIARIES, JUNE 2009

Note: Represents 51.9 million persons receiving Social Security benefits in June, 2009.

Source: CRS analysis of administrative data from the Office of the Actuary of the Social Security Administration.

In June 2009, the average monthly benefit for a man receiving a Social Security retired worker benefit was \$1,305, while the average retired worker benefit for a woman was \$1,006. Men had higher benefits because they had both higher average wages and a higher average number of years of earnings. The pattern was similar for disabled workers. The average monthly benefit in June 2009 for a man receiving SSDI was \$1,188, while for a woman receiving SSDI, the average monthly benefit was \$921. The average benefit for a widow(er) or parent was \$1,086. Benefits for spouses and children are typically about half of an insured worker's PIA. In 2009, the average Social Security spousal benefit was \$553 and the average child's benefit was \$548.

FIGURE 5: MEAN MONTHLY SOCIAL SECURITY BENEFIT BY BASIS OF ELIGIBILITY, JUNE 2009



Source: CRS analysis of administrative data from the Office of the Actuary of the Social Security Administration.

How Does Social Security Compare with Other Sources of Income?

Social Security provides a substantial proportion of total income among households in which one or more residents is a Social Security beneficiary, and its importance as a source of income increases as people age. In 2008, Social Security provided more than 25 percent of the total income of households in which at least one household resident was a Social Security beneficiary and the household head and his or her spouse (in married-couple households) were both under 65 years old (See **Table 11**). Earnings were the largest share of income among these households, primarily because in many instances there were other household members who worked. Pensions were the third largest share of income in Social Security beneficiary households in which both the household head and spouse were under age 65, accounting for 8.3 percent of total household income in 2008.

Social Security is the largest share of income among Social Security beneficiary households headed by persons aged 75 and older, providing 46.2 percent of all income received by these households in 2008. Pensions were the second largest share of income among these households, accounting for 19.3 percent of their total income. Although earnings were a substantial source of income, the portion of total income received as earnings in 2008 (16.6 percent) was much lower among households headed by persons aged 75 and older than among

beneficiary households headed by persons aged 65 to 74 (36.7 percent) and beneficiary households headed by persons under age 65 (56.2 percent). Social Security beneficiary households headed by persons aged 75 and older received 14.8 percent of their total income from assets in 2008.

Table 11. Shares of Household Income in 2008 Among Beneficiary Households, by Age of Householder

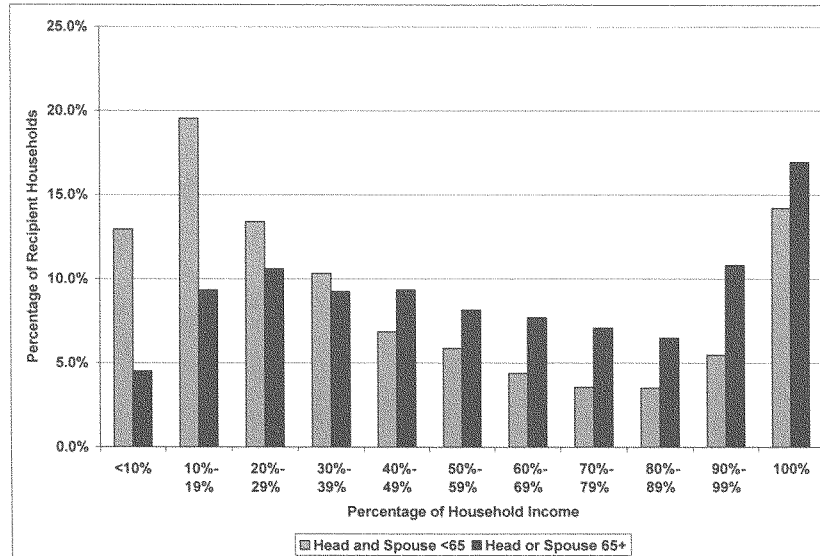
Source of Income	<i>Age of Household Head</i>		
	Under 65	65 to 74	75 and Older
Social Security	25.5%	33.1%	46.2%
Earnings	56.2%	36.7%	16.6%
Pensions	8.3%	16.6%	19.3%
Assets	4.3%	11.2%	14.8%
Public Assistance	1.2%	0.4%	0.4%
Other	4.5%	2.0%	2.7%
Total	100%	100%	100%

This table illustrates the sources of income of beneficiary households in the aggregate. Many households receive income from two or more of the sources.

Source: CRS analysis of the March 2009 Current Population Survey.

Some households that receive Social Security have no other source of income. **Figure 6** shows the percentage of total household income received by Social Security beneficiary households headed by persons under age 65 and age 65 and older in 2008. Among Social Security beneficiary households in which both the household head and spouse (in married-couple households) were under age 65, 14 percent had no income other than Social Security. Among beneficiary households in which either the household head or spouse was 65 or older, 17 percent had no income other than Social Security. Including the households that received all of their income from Social Security, 37 percent of beneficiary households headed by persons under age 65, and 57 percent of beneficiary households headed by persons aged 65 and older, received more than half of their total income from Social Security.

Figure 6: Social Security as a Percentage of Household Income in 2008 among Beneficiary Households by Age of Household Head

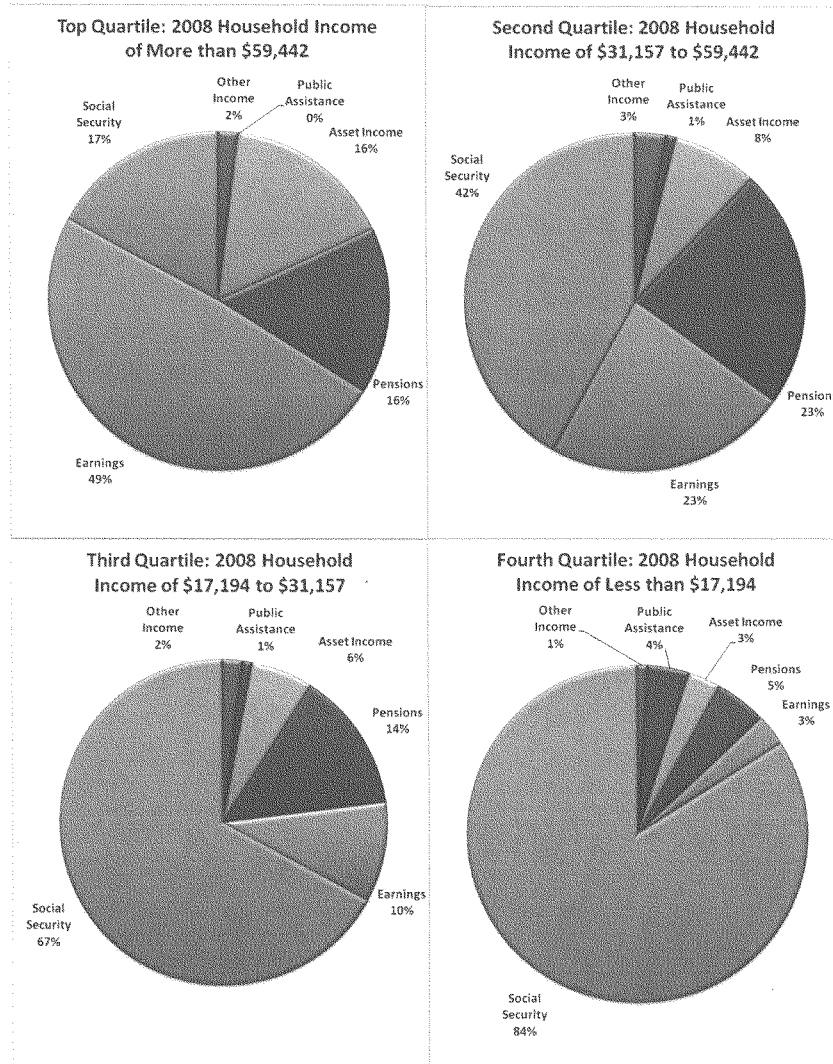


Source: CRS analysis of the Census Bureau's March 2009 Current Population Survey.

Sources of Income by Income Quartile

Figure 7 shows the percentage of total income received from each source by all households with any income in 2008, in which either the householder or householder's spouse was 65 or older. For example, among elderly households in the top 25 percent of total income, 17 percent of income came from Social Security, and 81 percent of total income came from earnings, pensions, and assets. In contrast, among elderly households whose income was in the lowest quartile, the ratio of Social Security to other income sources was inverted. Figure 7 shows 84 percent of income for households in the lowest quartile came from Social Security, and 11 percent of total income came from earnings, pensions, and assets. Elderly households in the second and third income quartiles in 2008 drew 42 percent and 67 percent of their income from Social Security, respectively.

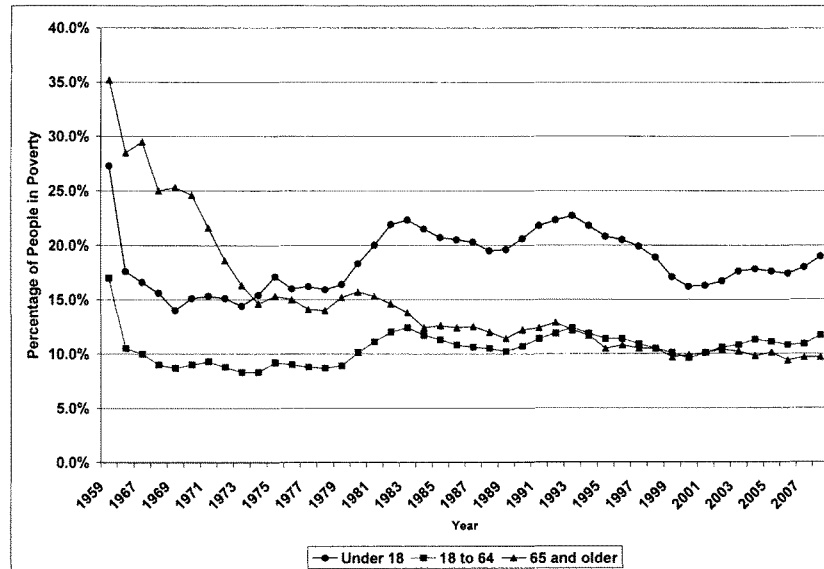
Figure 7: Sources of Household Income in 2008 for Household Head Aged 65+



Source: CRS analysis of the March 2009 Current Population Survey.

The percentage of older Americans living in poverty fell sharply from the late 1950s through the mid-1970s and then continued a slow, steady decline until the early 1990s, when it leveled off at about 10 percent. In 1959, 35.0 percent of Americans aged 65 and older had family incomes below the federal poverty threshold, which was more than double the poverty rate among adults 18 to 64 years old. (See **figure 8**.)

FIGURE 8: POVERTY RATE TREND LINES, 1959 TO 2008



Source: <http://www.census.gov/hhes/www/poverty/histpov/hstpov2.html> and the March 2009 CPS

By the early 1990s, the poverty rate among people 65 and older had fallen below the poverty rate among adults aged 18 to 64. The poverty rate of 9.7 percent among Americans aged 65 and older in 2008 was two percentage points lower than the poverty rate among adults aged 18 to 64, and it was just half the 19 percent poverty rate among children under 18 years old. However, while the proportion of persons aged 65 and older in poverty has fallen over the past 50 years, the number of poor elderly has remained relatively constant since the mid-1970s due to the growth in the total number of elderly persons. In 2008, 3.6 million people aged 65 and older had incomes below the federal poverty thresholds of \$10,326 for single elderly persons and \$13,014 for elderly couples.

The reduction in the proportion of older Americans living in poverty from 35 percent in 1959 to 10 percent in 2008 is one of the most significant economic developments to occur in the last 50 years. Without the decline in elderly poverty, the economic burden of supporting those who can no longer work in old age would weigh that much more heavily on their adult children,

and many millions of older Americans would likely have to apply for public assistance or give up their homes to live with their children. Both the increase in the proportion of older persons who receive Social Security and increases in average monthly benefits contributed to the decrease in the proportion of older Americans whose income falls below the federal poverty threshold.

The decline in poverty among the elderly is also due to the fact that the poverty threshold is adjusted each year by the rate of inflation as measured by the percentage change in the Consumer Price Index (CPI). The federal poverty threshold represents the amount of income necessary to maintain a minimally adequate standard of living. Because the poverty threshold is adjusted annually by the rate of inflation as measured by the consumer price index, the real (inflation-adjusted) value of income at the poverty threshold remains constant over time. In contrast, growth in wages from year to year reflects both the rising general level of prices and gains in labor productivity.

Over long periods of time, wages and salaries grow faster than prices because labor becomes more productive as a result of better education and training, improved methods of production and distribution, and new technologies. Over the past 50 years, the ratio of the poverty threshold to the median income of the population has fallen because earnings (which are the largest source of income for most non-elderly households) have risen faster than prices. As a consequence, the gap between the official poverty threshold and the median household income has grown, and persons with incomes at or below the poverty threshold have become relatively poorer compared to households with incomes at the median.

In 1968, the poverty threshold for an individual 65 or older (\$8,308 in 2008 dollars) was equal to 93 percent of the median individual income (\$8,962 in 2008 dollars) of all persons aged 65 and older. In 2008, the poverty threshold for a single person 65 or older (\$10,326) was only 57 percent of the real median income of individuals aged 65 and older (\$18,208). In the future, other things being equal, the disparity between rising real incomes and a fixed real poverty threshold will lead to a decreasing proportion of the elderly having incomes below the federal poverty threshold. This means that the income gap between those with incomes below the poverty threshold and those with incomes at the median will grow larger. As a result, the proportion of the elderly who are in poverty will shrink, but those who are in poverty will be relatively poorer compared to those who have average incomes.

Due to these problems with a fixed poverty measure, Congress requested the National Academy of Sciences to convene a group of experts to update and improve the measurement of poverty. Its 1995 report³⁴ recommended a broader definition of necessary expenditures (that includes food, housing, out-of-pocket health care expenses, child support expenses, and work-related expenses such as transportation and childcare) and a more refined measure of income (that takes into account taxes, tax credits, and in-kind benefits such as food stamps and housing subsidies). When this more realistic measure is used, poverty among seniors is much

³⁴ Citro, C. F., & R. T. Michaels, eds., *Measuring Poverty: A New Approach*, Washington, DC: National Academy Press, 2005, available at http://www.nap.edu/catalog.php?record_id=4759.

higher than it appears as calculated by traditional means,³⁵ e.g. from 10 to 19 percent in 2008, due in large part to recognition of out-of-pocket health spending as a basic necessity.

Social Security Modernization: Setting the Stage

The Social Security program is not currently on a long-term path of fiscal stability. According to the 2009 Trustees Report, without Congressional action the program will exhaust the Trust Funds beginning in 2037, and thereafter only collect enough revenue to pay out 76% of promised benefits. To restore long-term solvency, policymakers face three basic options: raise contributions, cut benefits, or add revenues to the system. The following section will outline several alternatives for improving solvency, derived from NASI's October 2009 report entitled *Fixing Social Security: Adequate Benefits, Adequate Financing*.³⁶ The solvency impact of the reforms are estimated by the Social Security Administration's Office of the Actuary³⁷ and, where appropriate, CRS estimates of the impact of these changes on future beneficiaries are included.³⁸

As Congress explores potential reforms to Social Security, it should not only strive to improve the fiscal health of the program, but also ensure that it will meet the needs of beneficiaries in years to come. The Committee requested that GAO review options to strengthen the program for the most vulnerable populations and their findings are included herein.³⁹

It is important to note that the policy alternatives described in the subsequent sections of this report by no means represent an exhaustive list and are limited to Social Security retirement and survivor benefit programs. Rather, they illustrate the more commonly considered proposals for restoring the program's fiscal alignment and improving the protections of vulnerable groups. Variations or combinations of these proposals could also prove useful to Congress as they consider Social Security reform.⁴⁰

The projected actuarial impacts of these reforms are provided on the assumption that each reform was to be implemented now or as described under the option, and that no other changes were made. Projecting the impacts of combinations of options and/or different implementation timeframes would require a new and thorough analysis. Further, these analyses should be

³⁵ Reno, Virginia P. and Ben Veghte, "Economic Status of the Aged in the United States", in Robert Binstock et al., ed., *Handbook of Aging in the Social Sciences*. (Maryland Heights, MO: Elsevier, forthcoming).

³⁶ Reno, Virginia P. and Joni Lavery, *Fixing Social Security: Adequate Benefits, Adequate Financing*, National Academy of Social Insurance, October, 2009, available at <http://www.nasi.org/research/2009/fixing-social-security>.

³⁷ All estimates of the solvency impact of individual proposals are based on the 2009 Trustee's Reports, available at: <http://www.ssa.gov/OACT/TR/2009/index.html>.

³⁸ Haltzel, Laura, Dawn Nuschler, Kathleen Romig, Gary Sidor, Scott Szymendera, Mikki Waid, and Debra Whitman, "Options to Address Social Security Solvency and Their Impact on Beneficiaries: Results from the Dynasim Microsimulation Model," Congressional Research Service Report RL33840, January 29, 2007, available at http://www.aging.senate.gov/crs/crs_social_security_policy.cfm.

³⁹ GAO, *Social Security: Options to Protect Benefits for Vulnerable Groups When Addressing Program Solvency*, GAO-10-101R (Washington, D.C.: December 7, 2009), available at <http://www.gao.gov/new.items/d10101r.pdf>.

⁴⁰ For example, see Committee on the Fiscal Future of the United States, "Choosing the Nation's Fiscal Future," National Academies Press 2010, available at http://www.ourfiscalfuture.org/wp-content/uploads/fiscalfuture_full_report.pdf.

detailed enough to understand how they would impact vulnerable groups and protect the adequacy of Social Security benefits.

Options to Raise Revenue for Program Solvency

Options to Increase the Social Security Contribution Rate

The Federal Insurance Contributions Act of 1939 (FICA) authorized the Social Security program to be financed largely by mandatory contributions from workers and employers. This established a link between funding and insuring against economic insecurity when wages are lost due to old age, death of a family worker, and, later, disability. Some options for adjusting the contribution rate are:

- **Increase Worker and Employer Contributions by 1.1 percent.** If the contribution rate were raised in 2010 so that workers contribute 7.3 percent instead of 6.2 percent of their earnings, the program's projected deficit would decline by 2.09 percent of taxable payroll. It is estimated that this change would eliminate all of the deficit and make the program solvent for 75 years. For example, a medium-wage worker, making \$43,451 in 2010, would face a tax increase of \$478 a year, or \$9.19 a week, and the employer would face an identical increase. However, because the program will have surplus funds for the next decade, an immediate rate increase would add to the surpluses that are invested in Treasury securities.
- **Increase Worker and Employer Contributions by one percent in 2022, and by an Additional one percent in 2052.** Because the Social Security program has sufficient resources to pay benefits in the near future, contribution rates could be designed to increase as funds are needed. If determined by future policymakers that funds are not needed, the rates could be reduced or rescinded. As one example of this approach, policymakers could act now to schedule a two-step increase in the Social Security rate: from 6.2 percent to 7.2 percent for workers and employers in 2022, and to 8.2 percent in 2052. This option would reduce the program's projected deficit by 2.06 percent of payroll, eliminating the projected 75-year shortfall. By 2022, workers' real wages—that is, their purchasing power after adjusting for inflation—is estimated to be about 16 percent higher than in 2009. If two percent more of workers' wages went to support Social Security, workers would still be 14 percent wealthier than today's workers. By 2052, wages are projected to have 56 percent greater buying power than in 2009.
- **Increase Worker and Employer Contributions 1/20 percent Annually for 20 years.** To avoid abrupt changes in Social Security contribution rates, this option would schedule gradual increases in the Social Security contribution rate (i.e., one-twentieth of one percent per year over 20 years for employees and employers, each) beginning in 2015, increasing the rate to 7.2 percent by 2035. In 2015, the increase for an average earner making \$53,085 then would be \$26.50 a year, or about 50 cents a week. It is estimated

that this approach would reduce the 75 year shortfall by 1.39 percent of taxable payroll or about 69 percent.

- **Raise Rates Based on the Trustees' Most Current Intermediate Assumptions of the Tax Rate Needed to Balance Revenues and Outlays.** This option would increase Social Security contribution rates in order to correct future estimates of insolvency. The balancing rate would be based on the Trustees' most current intermediate assumptions of the tax rate needed to balance revenues and outlays over the entire 75 year projection period, and would take effect automatically if Congress did not adjust revenues and costs. When long-range forecasts change, the future fail-safe rate would be automatically adjusted to maintain financing for the next 75 years.
- **Enhance Collection of Existing Taxes.** The tax gap is the amount of taxes that are legally owed, but not collected, by the federal government in a timely fashion or at all. The IRS estimates the total tax gap at about \$345 billion a year, of which approximately \$58 billion is in Social Security and Medicare payroll taxes (most of the \$58 billion is from Social Security payroll taxes).⁴¹ Increasing the collection of unpaid Social Security payroll taxes could significantly reduce the funds needed to make Social Security solvent over the next 75 years.

Options to Consider Broadening the Revenue Base for Social Security

As of 2009, workers' wages subject to Social Security contributions amount to 39 percent of national income, or gross domestic product (GDP).⁴² Some have argued that almost everyone benefits from Social Security; therefore, broadening sources of income would be more equitable. For example, many of the sources of non-taxed income disproportionately benefit upper income individuals. The sources of income not currently taxed include:

- Earnings above the tax cap (about 17 percent of aggregate earnings);
- Earnings of workers not covered by Social Security (about 25 percent of state and local government employees do not to participate in Social Security);
- Non-taxable fringe benefits paid by employers, such as health insurance premiums, pensions, and most other employee benefits;
- Employees' tax-favored contributions to "salary reduction" plans for purposes other than retirement (such as out-of-pocket spending for health care, child care, or work expenses);

⁴¹ The Internal Revenue Service estimates that in 2001 there were \$39 billion in underreported self-employment taxes, \$14 billion in underreported FICA, and five billion dollars in underpaid employment taxes. United States Department of the Treasury, "Update on Reducing the Federal Tax Gap and Improving Voluntary Compliance," July 2009, available at http://www.irs.gov/pub/newsroom/tax_gap_report_final_version.pdf.

⁴² 2009 Social Security Trustees' Report, available at <http://www.ssa.gov/OACT/TR/2009/tr09.pdf>.

- Income from capital, such as interest on investments, stock dividends, and rental income from real estate; and
- Realized increases in the value of property (capital gains) and transfers of property (through gifts and inheritance).

Options to Modify the Social Security Tax Cap

In 2010, only earnings up to \$106,800 are taxed and counted toward workers' future Social Security benefits. The cap is indexed to keep pace with the growth in average earnings of all workers. In the past, Congress set the level of the cap to cover 90 percent of the aggregate wages of all workers.⁴³ Today, it covers only about 83 percent of such earnings.⁴⁴ The decline occurred because those at the top of the income distribution (the roughly six percent of workers who make more than the cap) have had more growth in earnings than those who make less than the cap. In 2010, the maximum Social Security retirement benefit that could be received would be \$2,346 per month (\$28,152 per year) if they retired at the full retirement age of 66.⁴⁵

- **Eliminate the Cap – Do Not Count the Additional Earnings toward Benefits.** If all earned income above \$106,800 a year were subject to Social Security contributions but did not count toward benefits, Social Security would be solvent throughout the long-range projection period. Making this change in 2010 would reduce the program's projected deficit by 2.32 percent of payroll, thereby eliminating the 75-year deficit. However, with this change, workers who earn more than the tax cap would pay considerably more in taxes in a given year. For example, a person making \$400,000 per year would pay \$18,178 more per year and his or her employer would pay a matching amount, for a total increase of \$36,356. CRS projects that eliminating the cap on contributions would impact roughly one in five beneficiaries over his or her lifetime. As workers do not generally have high earnings over their entire careers, the total increase in taxes paid by individuals over their working lives would be relatively small with a median increase in lifetime contributions of three percent. Notably, under this option the worker's maximum benefit would be no higher than under current law changing the historic relationship between contributions and benefits.
- **Eliminate the Cap – Count the Earnings toward Benefits.** If all wages above \$106,800 in 2009 were taxed and counted toward benefits, the change would almost make Social Security solvent through the long-range period, reducing the payroll deficit by 1.89 percent and eliminating about 95 percent of the 75-year shortfall. While high earners and their employers would pay considerably more, these top earners would also receive much higher benefits. For example, one who had paid taxes on lifetime annual earnings of

⁴³ Altman, Nancy J, "Tier II Supplement to Social Security: The Retirement-USA Plus Plan," presented at the Retirement-USA Symposium (October 21, 2009).

⁴⁴ Janemarie Mulvey, "Social Security: Raising or Limiting the Taxable Earnings Base," Congressional Research Service, February 17, 2010. (RL32896). Available at http://www.aging.senate.gov/crs/crs_social_security_policy.cfm.

⁴⁵ 2009 Social Security Trustees' Report, Table VI.F10, <http://www.ssa.gov/OACT/TR/2009/tr09.pdf>.

\$400,000 would get a benefit of about \$6,000 per month, or \$72,000 per year, which would replace about 18 percent of the worker's average earnings.

- **Eliminate the Cap – Count Earnings toward Benefits Using Different Formula.** If all earnings above the cap were taxed and counted toward benefits, policymakers could decide to change the benefit formula to replace a smaller portion of earnings above the old cap as a way to avoid paying very high Social Security benefits. As previously noted, the Social Security programs' formula is based on workers' average indexed monthly earnings (AIME) in three brackets. In 2009, Social Security paid:
 - 90 percent of AIME up to \$744, plus
 - 32 percent of AIME between \$744 and \$4,483, plus
 - 15 percent of AIME over \$4,483

A modified formula might apply the 15 percent bracket only up to the old cap, and then provide a smaller replacement, say three percent of earnings, above that. For example, the third part of the above formula could be modified to:

- 15 percent of AIME between \$4,483 and \$8,900 (\$106,800 divided by 12), plus 3 percent of AIME over \$8,900

This option, starting in 2010, is estimated to eliminate the 75-year deficit, resulting in savings of 2.17 percent of payroll.

- **Gradually Restore the Cap to Cover 90 percent of Earnings.** Gradually increase the taxable earnings base to include 90 percent of earnings by increasing the base by two percent per year above the growth in average wages. For example, the maximum taxable base in 2010 would rise to \$2,136 (two percent of \$106,800) beyond the automatic increase. In practice, the deductions from earnings for the highest-paid six percent of workers would continue for a few days longer into the year (and for their additional contributions they would receive somewhat higher benefits). For the 94 percent of covered workers with earnings below the cap, there would be no change at all. The change would bring the taxable maximum to the 90-percent level in about 36 years and is projected to reduce the 75-year deficit by 28 percent, or 0.60 percent of taxable payroll. Similar to current law, the roughly one percent of the population with earnings above the 90 percent cap would not pay taxes on earnings above the new threshold.
- **Gradually Restore the Cap to Cover 90 percent of Earnings for Workers and Eliminate the Contribution Cap for Employers.** Similar to the proposal above, the taxable earnings base would be gradually increased until it covered 90 percent of aggregate earnings, however it would only apply to the worker's share (6.2 percent) of the payroll tax. In addition, employers would pay their share of the payroll tax (6.2 percent) on the full wages of their employers with no maximum amount. Self-employed individuals, who currently pay the full 12.4 percent payroll tax, would have a mixed basis for calculating their contributions. Retirement benefits would be based only on the

workers earnings below the revised taxable maximum. This option would reduce the 75-year deficit by 69 percent, or 1.37 percent of taxable payroll.

Options to Extend Social Security Coverage to all Workers

As described previously, almost all workers pay into Social Security, with the exception of the roughly 25 percent of state and local government employees who are covered by alternative pension systems.⁴⁶ When Congress last extended coverage in 1983, it brought all newly hired federal employees into Social Security but did not extend that requirement to non-covered State and local employees.⁴⁷ However, Congress no longer allowed states that provide Social Security coverage to drop that coverage.

Extend Social Security Coverage to Newly-Hired Non-covered State and Local Government Employees. In order to achieve more universal coverage under Social Security, newly hired state and local government workers could be required to participate in Social Security. Under this proposal, these workers would be required to pay Social Security taxes and be eligible to receive benefits. This change may also impact the funding of the state and local government of pension systems. State and local governments would need time to modify their pension systems to fit with the Social Security program, as was done for newly-hired federal employees after 1983. If, over a five year period, all newly-hired state and local employees were brought into Social Security coverage, this change is projected to reduce the 75-year deficit by about nine percent, or 0.17 percent of payroll. The slight increase in revenue occurs because the newly-covered workers and employers start to pay into Social Security immediately, but claim benefits in the future.

Option to Treat All Salary Reduction Plans Like 401(k)s. Under the 1983 amendments to Social Security, employees pay Social Security and Medicare taxes on their contributions to retirement accounts, such as section 401(k), 403(b) and 457 plans, but they do not pay Social Security and Medicare taxes on their payments into other types of salary reduction plans, or “flexible spending accounts.” These are accounts that employers set up to allow their workers to exclude from taxable income out-of-pocket spending for health care, dependent care, or qualified commuting costs for parking, van pooling, or transit fares (Joint Committee on Taxation 2005).⁴⁸ Employee contributions to both 401(k)s and other flexible spending accounts are exempt from personal income taxes for employees.

⁴⁶ U.S. Committee on Ways and Means, “Background Material and Data on Programs within the Jurisdiction of the Committee on Ways and Means, 2004,” The Green Book, House Ways and Means Committee Print, Washington, DC: Government Printing Office, available at <http://waysandmeans.house.gov/media/pdf/111/ssgb.pdf>.

⁴⁷ Following the 1983 legislation, a new Federal Employees Retirement System was set up to supplement Social Security coverage for newly-hired federal employees. Employees hired before 1984 could elect to join the new system and be covered by Social Security or to remain in the older Civil Service Retirement System. The number of federal employees not covered by Social Security is gradually declining.

⁴⁸ Joint Committee on Taxation, Testimony of George K. Yin, Chief of Staff of the Joint Committee on Taxation at a Hearing of the Senate Committee on Finance on “Social Security: Achieving Sustainable Solvency,” JCX-38-05, May 25, 2005, available at <http://finance.senate.gov/imo/media/doc/gytest052505.pdf>.

The legislative rationale for keeping 401(k) contributions subject to Social Security and Medicare taxes was to ensure that such plans are not used to avoid Social Security tax liability and that employees receive Social Security protection based on those wages.⁴⁹ This rationale applies equally to salary reduction plans used for other purposes.⁵⁰ Exempting employee payments into flexible spending accounts from Social Security and Medicare taxes means that the respective Trust Funds are deprived of both the employee contributions and the employers' matching share of Social Security and Medicare contributions. If all employee contributions into salary reduction plans were treated like 401(k) contributions and subject to the payroll tax, it is projected that the 75-year deficit in the Social Security program would be reduced by about 12 percent, or 0.25 percent of taxable payroll.

Options to Use Progressive Taxes to Cover Social Security's Legacy Costs

As described in the previous section, one reason the Social Security program faces fiscal deficits is due to the estimated \$13 trillion in intergenerational transfers,⁵¹ or "legacy costs", that arose from current generations of retirees providing for their parents' and grandparents' retirement income security during the early years of the program. Some have argued that revenue to pay for these costs should be raised in ways other than the Social Security payroll tax and have proposed dedicating revenue from the estate tax to the Social Security Trust Funds or levying a new legacy tax on earnings above the tax cap on high-income households.

- **Dedicate Estate Tax Revenue at the 2009 Level to Social Security.** Revenue from the estate tax could be used to cover part of Social Security's legacy cost. In 2009, the estate tax applied only to the value of an estate in excess of \$3.5 million if it is not left to a surviving spouse, who can inherit all assets tax-free.⁵² Values above that level not inherited by a spouse are taxed at 45 percent, with 55 percent going to non-spouse heirs. The estate tax is slated to fall to zero in 2010, and then revert to the higher tax rates applicable in 2001 (a 55 percent tax on estates over \$1 million for individuals and \$2 million for couples). Preserving the estate tax into the future, and dedicating the revenue from the tax with the 2009 level of exclusion and tax to Social Security, would reduce the long-term deficit by 0.51 percent of payroll, thereby eliminating about one fourth of the deficit.⁵³ This estimate assumes that the estate tax threshold for Social Security revenue will remain \$3.5 million for all future years. If the amount of the estate tax exemption rose with the consumer price index, this option would reduce the 75-year deficit by 0.40 percent of payroll or about one-fifth of the deficit.

⁴⁹ Social Security Administration. 2009. Social Security Amendments of 1983; H. R. 1900.

⁵⁰ Joint Committee on Taxation, 2005.

⁵¹ Diamond, Peter A. and Peter R. Orszag, "Saving Social Security: A Balanced Approach," Washington, DC: Brookings Institution Press, 2004.

⁵² Each member of a couple can leave \$3.5 million to non-spouse heirs without incurring any tax liability, thus shielding from taxation married couples' estates valued up to \$7 million.

⁵³ If Congress allowed the estate tax to return to its higher 2001 level in 2011, then this option would use part of estate tax revenue to pay for Social Security and part would go to general revenues.

- **Three percent Legacy Tax on Earnings Above the Tax Cap.** A legacy tax on earnings above the taxable earnings cap could be raised as a way to ensure that very high earners contribute to financing Social Security's legacy cost in proportion to their full earnings. If a three percent legacy tax on earnings above the tax cap began in 2010 (1.5 percent for workers and employers each) and the higher earnings did not count toward benefits, the long-term deficit would be reduced by 0.57 percent of taxable payroll, or by just over one-fourth.
- **Three percent Legacy Tax on Adjusted Gross Income (AGI) over \$250,000 for Couples and \$125,000 for Individuals.** The legacy tax threshold could be raised to eliminate increases on the middle class. Dedating to Social Security a three percent legacy tax on AGI over \$250,000 for couples and \$125,000 for individuals starting in 2010 is projected to reduce the 75-year deficit by 0.74 percent of taxable payroll, thereby reducing the deficit by just over one-third, assuming thresholds indexed by average wage growth.
- **Five percent Legacy Tax on Adjusted Gross Income over \$250,000 for Couples and \$125,000 for Individuals.** Dedating to Social Security a five percent legacy tax on AGI over \$250,000 for couples and \$125,000 for individuals is projected to reduce the 75-year deficit by 1.23 percent of taxable payroll, thereby eliminating roughly three-fifths of the deficit.

Options to Maintain Reserves and Diversify Investments

As part of a Social Security financing strategy, the federal government could increase and maintain large reserves so that the investment income would remain as a permanent source of support for Social Security. A portion of these Social Security funds could be invested in equities as is done by most other public and private pension plans. Several other government pension programs, such as those for employees of the Federal Reserve System, the Tennessee Valley Authority, and the Railroad Retirement Board, already make such direct investments in stocks, as does the Canadian social insurance system.

Investing in equities would add risk to the investment portfolio and exposes the Trust Funds to increased liabilities in times of economic downturn. The impact on program solvency depends on the assumptions about the long term rates of return of equities relative to Treasury bonds. If they are equal, then diversifying investments will have no impact on solvency. The rate of return on equities has traditionally outpaced the return on bonds, however, some economists argue that the difference in the returns corresponds to the difference in risk between these assets. The following are proposed options for investing a portion of these funds in the equity markets, with projected impacts based on high, medium, and low rates of return.

- **Gradually Invest 15 percent of Trust Fund Assets in Equities.** The government could gradually invest Trust Fund assets in a broad index of equity market securities, such as the Wilshire 5000. If the Trust Funds' investments in equities increased by 1.5 percent a year for 10 years and equity investments were maintained at 15 percent thereafter, it

would reduce the long-range deficit by about 14 percent, or 0.27 percent of taxable payroll. These calculations assume that Trust Funds invested in equities earn a constant nominal 9.4 percent return (or 6.4 percent real return over 2.8 percent inflation) this is 3.5 percentage points over the expected average yield on long-term Treasury bonds. If one assumes that the investment earns the same return as Treasury bonds (2.9 percent real), there would be no impact on the 75-year deficit.

- **Gradually Invest 40 percent of Trust Fund Assets in Equities.** Alternatively, a larger portion of Trust Fund assets could be invested in equities. If 40 percent of the Trust Funds' assets were invested in equities, phased in over 15 years (between 2010 and 2024), and invested in a broad index of equity markets which earned a 9.4 percent nominal return (or a real return of 6.4 percent on top of inflation), it would eliminate one third of the long-range deficit and reduce the long-term deficit by 0.67 percent of payroll. If, instead, the same investment policy ended up producing a smaller return of 8.4 percent (or a real return of 5.4 percent on top of inflation), the policy could reduce the long-term deficit by 0.48 percent of taxable payroll, thereby eliminating about one-fourth of the long-term deficit. If one assumes that the investment earns the same return as Treasury bonds (2.9 percent real), there would be no impact on the 75-year deficit.

Options to Reduce Benefits to Address Program Solvency

Options that would lower future benefits to balance long-term finances include those that would reduce the annual cost-of-living adjustment (COLA), increase the age for receiving full retirement benefits, lengthen the average period used to calculate lifetime earnings, lower benefits for new beneficiaries, and lower the benefit payable to spouses of retired workers.

Options to Reduce the Cost-Of-Living Adjustment

Under current law, Social Security benefits are automatically adjusted each year to keep up with the cost of living, as measured with the Consumer Price Index for Urban Wage Earners and Clerical Workers (CPI-W). Some proposals would lower Social Security benefit costs by changing the way in which Social Security benefits are adjusted to keep pace with inflation. Some proposals would pay less than the full COLA by adjusting benefits by the COLA minus one percent, or minus half of one percent. Another proposal would shift to a new index. Groups of beneficiaries with relatively long periods of eligibility for benefits, including older beneficiaries, women, survivors, disabled beneficiaries, and low-income beneficiaries, would face the most significant impacts on their benefits from COLA reductions. These categories of beneficiaries also have the highest rates of poverty and are the most reliant on income from Social Security.

- **Reduce the COLA by one percent each year.** If the annual COLA increase for Social Security beneficiaries were reduced by one percentage point, the long-term deficit would decline by 1.55 percent of taxable payroll, or about 78 percent. If inflation were 2.8 percent per year (as assumed by the Trustees), the annual increase for beneficiaries would be 1.8 percent per year. This change would impose the greatest burden on the

oldest beneficiaries because the reductions accumulate over time. For example, a 92-year-old beneficiary would have the purchasing power of her or his benefits eroded by 25 percent if the cost of living went up by 2.8 percent every year, but he or she received only a 1.8 percent increase each year.

- **Reduce the COLA by one-half percent each year.** If policymakers reduce the COLA by half a percentage point, this could potentially reduce the long-range deficit by 0.81 percent of taxable payroll, thereby eliminating about 40 percent of the shortfall. In this scenario, a 92-year-old beneficiary would see the purchasing power of his or her benefits eroded by 14 percent if inflation were 2.8 percent per year, but she or he received only a 2.3 percent annual increase.
- **Adopt the “Chained” Consumer Price Index (CPI).** Social Security benefits are now automatically adjusted by changes in the CPI-W, as measured by the Bureau of Labor Statistics (BLS). The BLS has developed a new “chained” CPI. It differs from the CPI-W in that it takes into account purchasing substitutions across broad categories of goods and services (such as spending less on food to pay for higher-priced gasoline). Because the “chained” CPI is expected to increase about 0.3 percent slower each year than the CPI-W, this change would reduce the long-run deficit by 0.49 percent of taxable payroll, thereby shrinking the shortfall by nearly one-fourth. Proponents of this approach argue that the chained CPI is a more accurate and up-to-date measure of the cost of living. Opponents point out that while it may be more accurate for the general population, it may be less accurate for seniors who spend a larger share of their incomes on health care. To the extent that the chained CPI understates increases in the cost of living for beneficiaries and is lower than the CPI-W, the oldest beneficiaries could have significant reductions in their benefits, as would be the case with all COLA reductions.

Options to Raise the Age for Full Retirement Benefits

The age at which retirees can collect full Social Security benefits is now 66 years for people born in 1944 (who reach 65 in 2009). It is scheduled to rise to 67 for those born in 1960 or later. Increasing the full benefit age would improve Social Security’s long-range finances because such a change would further lower benefits for all future retirees. For example, when the full benefit age was 65, benefits starting at age 62 were reduced by 20 percent; when the full benefit age reaches 67, benefits starting at 62 will be reduced by 30 percent, while benefits taken at age 65 will be reduced by 13.3 percent.

Proponents of increasing the full benefit age believe that retirement ages should rise as people are living longer and that a reduction in benefits would encourage individuals to work longer. Opponents point out that Social Security’s full-benefit age (67 in the near future) is already much older than eligibility ages in private or public pension plans, which remain 65 or earlier, and that working longer may not be an option for those in physically demanding jobs or for those who cannot find work. Moreover, the full-benefit age is older than the ages for penalty-free withdrawals from 401(k)s or IRAs (59 ½). As under current law, benefits for the disabled will be unaffected.

- **Accelerate the Increase to 67; then Increase the Full-Benefit Age by One Month Every Two Years to Age 68.** If policymakers speed up the increase in the full-benefit retirement age to reach 67 for those born in 1953 or later, and raise the age one month every two years until it reaches age 68 for people born in 1977 and later, these changes are estimated to reduce the long run deficit by 0.46 percent of taxable payroll. This would eliminate just under one-fourth of the long-term deficit. Under this change, when the full benefit age is 68, benefits starting at age 65 would be reduced by 20 percent and benefits starting at age 62 would be reduced by about a third.
- **Accelerate the Increase to 67; Then Increase the Full-Benefit Age by One Month Every Two Years to Age 70.** This option would continue to increase the full-benefit age to 70. If policymakers speed up the increase in the full-benefit retirement age to reach age 67 for those born in 1953, and then extend it one month every two years until it reaches age 70 for people born in 2025, these changes would reduce the long-term deficit by 0.62 percent of taxable payroll. This would eliminate just under one-third of the long-range shortfall. With this change, the benefit reduction for early retirement would be larger. When the full-benefit age reached 70, benefits starting at age 65 would be reduced by 30 percent and benefits starting at age 62 would be reduced by 45 percent.
- **Gradually Index the Full-Benefit Age for Longevity Indefinitely.** After the full-benefit age reaches 67 for those born in 1960, the full-benefit age would increase by one month every two years for those born after 1960. It would increase to age 68 for those born in 1984, to 69 for those born in 2008 and to about age 70 for individuals born in 2032. This schedule roughly matches assumptions about increasing life expectancy for people reaching age 65 in the future. This change would reduce the long-run deficit by 0.40 percent of taxable payroll, thereby eliminating about 18 percent of the long-term shortfall.

Options to Lengthen the Career-Earnings Averaging Period

As described previously, Social Security benefits are based on a formula that uses a worker's highest 35 years of earnings. Increasing the number of work years for calculating average lifetime earnings will lower future benefits because the additional years of earnings included in a worker's average lifetime earnings will be lower than each of the 35 years now used. This reduction would have the greatest impact on individuals, especially those who are less educated, low-income workers and women, with gaps in their paid work or individuals who spent part of their working lives not covered by Social Security because the additional years included would likely be years with zero earnings. It would have a small impact on individuals who had steady and consistent covered work records of 38 or 40 or more years of work.

- **Increase the Averaging Period from 35 to 38 Years.** An increase in the number of years used to calculate average lifetime earnings for retirement and survivor benefits (but not for disabled workers) from 35 to 38, phased in from 2010 through 2014, would

reduce the long-term deficit by 0.29 percent of taxable payroll, thereby shrinking the shortfall by about 14 percent.

- **Increase the Averaging Period from 35 to 40 Years.** Lengthening the averaging period to 40 years, phased in between 2010 and 2018, for retirement and survivor benefits (but not for disabled workers) would reduce the long-term shortfall by 0.46 percent of taxable payroll. It would shrink the shortfall by about one-fourth.

Options to Reduce Benefits for New Beneficiaries

Two options below illustrate the impact of immediate across-the-board reductions in benefits for new beneficiaries, while a third option gradually phases in reductions that exempt those with very low lifetime earnings. A fourth option gradually scales back benefits for dependent spouses (but not widowed spouses) of retired workers.

- **Reduce benefits by Three Percent for New Beneficiaries in 2010 and Later.** If benefits were reduced by three percent for everyone newly eligible in 2010 or later, this change would reduce program costs by 0.36 percent of taxable payroll, thereby reducing the 75- year deficit by just under one-fifth. This change would lower benefits for all new recipients, including retirees and their dependents, widowed spouses, disabled workers and their families, and families with children whose working father or mother died.
- **Reduce Benefits by Five Percent for New Beneficiaries in 2010 and Later.** If benefits were reduced by 5 percent for everyone newly eligible for benefits in 2010 or later, it is projected that it would reduce program costs by about 0.61 percent of taxable payroll, thereby lowering the long-range deficit by about three-tenths.
- **Price Index Benefits for Successive Generations Beginning in 2013.** Under current law, benefits for each successive age cohort (or generation) of new beneficiaries are indexed to keep pace with average-wage growth. The rationale for doing so is to provide stable replacement rates for future retirees across generations so that benefits for an average earner retiring at full-benefit age in any future year would replace the same portion of career earnings as for today's retirees. After entitlement, benefits are automatically adjusted to keep pace with price growth (inflation), with the aim of maintaining beneficiaries' purchasing power. A variety of options would gradually lower future benefit levels by indexing benefits for newly eligible retirees across generations by price growth instead of the higher average-wage growth. Many such plans would exempt the lowest earning retirees from the benefit reductions and are sometimes referred to as "progressive price indexing".⁵⁴ These proposals would make the largest benefit cuts for those who earned more and paid higher contributions over their careers. After a period of time under progressive price indexing, the majority of beneficiaries would receive the same flat benefit with little relation to what contributions they had made. The Social

⁵⁴ Patrick Purcell, Neela K. Ranade, and Laura Haltzel, "Indexing Social Security Benefits: The Effects of Price and Wage Indexes," Congressional Research Service, May 12, 2005 (RL32900), available at http://www.aging.senate.gov/crs/crs_social_security_policy.cfm.

Security Actuaries have estimated that one progressive price indexing proposal that exempted the bottom 30 percent of earners would be projected to reduce long-range costs by about 1.31 percent of taxable payroll, or by just under two-thirds of the long-range deficit.

- **Gradually Lower the Supplemental Spouse Benefit.** Under current law, the spouse (age 62 or older) of a retired or disabled worker can receive a benefit of up to 50 percent of the primary worker's benefit, but only to the extent the benefit exceeds what the spouse is entitled to on the basis of her or his own work record. One such option would gradually lower the supplemental spouse benefit for persons newly eligible in 2010 and later. The reduction from 50 to 33 percent of the primary worker's benefit would phase in by one percentage point a year over 17 years – from 49 percent for the newly eligible in 2010, to 33 percent for the newly eligible in 2026 and later. The change is estimated to lower the 75-year average costs by 0.12 percent of taxable payroll and reducing the long term deficit by about six percent. Reductions to the spousal benefits could also be combined with improving benefits for widowed spouses and/or for providing credit for caring for young children as part of the benefit that workers earn based on their own work records. However, depending on how the benefits are balanced, it could have a positive or negative effect on program solvency. Also, a reduction in supplemental spouse benefit applied to the benefits of divorced spouses could reduce benefits for a group already more likely to be poor.

Options to Protect Benefits for Vulnerable Groups

In order to modernize the Social Security, any proposal for reform must ensure benefits remain adequate for current and future vulnerable Americans who rely on Social Security the most. At the request of the Aging Committee, the Government Accountability Office (GAO) identified proposals for improving benefits for lifetime low earners, low-income women, and the oldest beneficiaries.⁵⁵ In certain cases, an option targeting one group may also address concerns about other groups due to the overlap in certain demographic groups. In addition to examining an option's impact on improving benefit adequacy, GAO examined the implications on program solvency and administration. Therefore, GAO's assessment is categorized as follows:

Adequacy: Retirement security experts and agency officials⁵⁶ had mixed views about the potential effectiveness of these options. While experts told GAO that several of these options could help address concerns about benefit adequacy, agency officials said they may not have the expected effects because of the complex rules governing Social Security benefits. An option's design will play an important role in determining its effectiveness.

⁵⁵ GAO, *Social Security: Options to Protect Benefits for Vulnerable Groups When Addressing Program Solvency*, GAO-10-101R (Washington, D.C.: December 7, 2009), available at <http://www.aging.senate.gov/letters/gaossreform.pdf>.

⁵⁶ See GAO, *Social Security: Options to Protect Benefits for Vulnerable Groups When Addressing Program Solvency*, GAO-10-101R (Washington, D.C.: December 7, 2009) for methodology, available at <http://www.aging.senate.gov/letters/gaossreform.pdf>.

Solvency: Because these options increase benefits, they have cost implications that affect the solvency of the Social Security system. The cost of a given option will depend on the number of people affected by it and the amount of the benefit increase. Additionally, cost will be affected by interactions with other elements of an overall Social Security modernization proposal. Key factors that influence cost are described for each of the options.

Administration: Implications for program administration vary among the options. Retirement security experts and agency officials said that some options could be fairly easy to administer, while others could be very complex. Even the less complex options could create additional work for SSA, such as monitoring eligibility for additional benefits. Options that increase the number of people eligible for benefits could add to SSA's administrative workload.

GAO identified and assessed the following modernization options:

Option: Guaranteeing a Minimum Benefit

Guaranteeing a minimum benefit by increasing Social Security retirement benefits for those who have worked in low-wage jobs throughout their careers addresses concerns about benefit adequacy. A "special minimum benefit" provision intended to increase benefit adequacy for low-earning steady workers was enacted in 1972.⁵⁷ However, because its eligibility threshold has not kept pace with wage growth, few people still qualify for the benefit. A number of proposals include a new minimum benefit option. The amount and structure of the benefit varies among proposals, but most minimum benefit options are designed to address benefit adequacy by providing a retirement benefit equal to some multiple of the federal poverty line, with the multiple based on years worked in covered employment. For example, one option would provide a minimum benefit equal to 120 percent of the poverty line for a minimum wage earner who had worked for 30 years. Another option would provide a minimum benefit equal to 100 percent of the poverty line for a 30-year worker and 111 percent of the poverty line for a 40-year worker.⁵⁸

Adequacy: The guaranteed minimum benefit option targets lifetime low earners, a vulnerable group that relies heavily on Social Security benefits for its retirement income. Retirement security experts said that this option targets a broader group of beneficiaries than proposals that focus on specific subgroups of low earners. SSA officials said that, depending on how this option is designed, it could work well, but it is difficult to target lifetime low earners effectively. For example, some officials and experts said that requiring a long work history is problematic because low earners often have recurring periods of unemployment and cannot satisfy such a requirement. Thus, the target population may not be reached if a lifetime of work is required to earn the benefit. However, other experts said that if a lifetime of work is not

⁵⁷The Social Security Amendments of 1972 added the "special minimum benefit" provision. (42 U.S.C. § 415(a)(1)(c) (i)).

⁵⁸ Other options would provide benefits ranging from 75 percent of the federal poverty line for those meeting the standard Social Security eligibility requirements (about 10 years of covered employment) up to 125 percent of the poverty line for a 30-year worker.

required, some people outside the target population would also benefit. For example, higher-wage workers who worked for a short period of time may also receive benefits.

The impact of this policy would likely decline over time, as the federal poverty line tends to grow slower than wages. Therefore, tying the minimum benefit to the federal poverty line could cause these benefits to lose value over time relative to the growth in the standard of living, similar to the current special minimum benefit. Future generations would have to find new benchmarks to ensure a minimum benefit remains adequate.

Solvency: Cost implications of this option depend on the number of work years required for eligibility, since that requirement will directly influence the number of people who would qualify for benefit increases. A shorter work requirement will result in more people being eligible, and thus costs will be higher. Additionally, most of the options reviewed set the benefit amount at some multiple of the poverty line.⁵⁹ The multiple used can have a significant impact on cost. For example, a guaranteed minimum benefit equal to 75 percent of the 2009 federal poverty guidelines would be \$677 per month, whereas a benefit equal to 125 percent of the guidelines would be \$1,128 per month.⁶⁰

Administration: For the most part, experts and SSA officials did not raise concerns about implementing and administering a minimum benefit option, although one expert said that policy makers would have to consider how to phase it into the Social Security system.

Option: Reducing Work Requirements for Eligibility

Reducing the work requirements for Social Security retirement benefit eligibility enables people who have shorter earnings histories to receive benefits. While some people who do not have 40 credits are still eligible for benefits based on the earnings of an eligible spouse, others do not qualify for any benefits. For example, a small number of unmarried individuals fail to qualify for benefits due to short earnings records. A reduced work requirement would allow people with shorter earnings records, potentially as short as a single credit of covered employment depending on how it is designed, to receive benefits. Benefit amounts would be calculated under the existing formula, which uses the worker's average indexed monthly earnings during the 35 years in which he or she earned the most, even if there were no earnings from covered employment during some of those years. SSI benefits exist outside of OASDI benefits to help those with shorter earning histories.

Adequacy: Reducing the Social Security work requirement is an option that targets workers with low lifetime earnings due to short work histories, as opposed to those with long histories of low earnings. SSA officials told GAO there are many people who fall just short of the 40 credits requirement because they have intermittent work histories. However, officials also said many of those people may already be eligible for spousal benefits, resulting in few people benefiting from this option. Other retirement security experts expressed similar opinions about

⁵⁹ How the initial benefit level increases for beneficiaries newly eligible in succeeding years would also influence costs. For example, over time, indexing the benefit to wages would be more costly than indexing to prices.

⁶⁰ This is a GAO calculation based on the 2009 federal poverty guideline of \$902.50 per month for a single-person home in all states, except Alaska and Hawaii, and the District of Columbia.

the limited number of people who would be helped by reduced work requirements. In addition, agency officials and experts said benefits based on such short work histories are likely to be very low and questioned the effectiveness of this option in addressing benefit adequacy. A proposal that includes this option simulated its potential effect and found similar limitations.⁶¹ This option could also expand eligibility to those who receive benefits from a pension for work in non-covered employment for state and local governments, but an offset, such as the Windfall Elimination Provision⁶² with some modifications, could be applied to those benefits.⁶³

Solvency: Because this option increases the number of people receiving benefits, it has cost implications for Social Security's solvency. The number of credits required will directly influence the number of people who would be newly eligible for benefits. A shorter work requirement will result in more people being eligible. However, because few people are actually expected to receive benefits under this option, and those who do are expected to receive modest benefits, the impact of a reduced work requirement on program solvency is unlikely to be very large.

Administration: Because few people are expected to gain eligibility under this option, the impact on SSA's workload is likely to be small.

Option: Supplementing Benefits for Low-income Single Workers

Supplementing benefits for low-income single workers by adjusting the formula used to calculate Social Security retirement benefits addresses concerns about benefit adequacy for that group. In one proposal, the first threshold in the benefit formula would be adjusted or supplemented so that it increased by one-half, from \$744 to \$1,116 in 2009, for eligible beneficiaries. The benefit amount would be capped to prevent eligible workers from receiving higher benefits than those who just miss qualifying for the supplement.

To be eligible for the supplement, a worker's AIME⁶⁴ must be lower than a multiple of the existing formula's first threshold, such as 150 percent or 300 percent. For example, if the multiple were set at 300 percent, a worker whose AIME was less than \$2,232 (3 x \$744) in 2009 would qualify. To receive the supplement, a worker must have at least 30 years of covered employment and the worker cannot be eligible for spousal benefits, nor can anyone else claim spousal benefits based on that worker's earnings record.

⁶¹ Andrew G. Biggs, "Enhancing Social Security benefits for low earners: Effects of reducing eligibility requirements for Social Security retirement benefits," National Academy of Social Insurance (Nov. 14, 2008), available at http://www.nasi.org/sites/default/files/research/Andrew_Biggs_January_2009_Rockefeller.pdf.

⁶² 42 U.S.C. § 415(a)(7).

⁶³ The Windfall Elimination Provision is an existing Social Security provision that reduces Social Security benefits for those who also receive pensions from employment that is not covered by Social Security. Noncovered workers do not pay Social Security taxes on their noncovered earnings. This provision is intended to treat such beneficiaries in a manner that parallels treatment of beneficiaries who paid Social Security taxes on all of their lifetime earnings.

⁶⁴ A worker's AIME is calculated based on a worker's highest 35 years' earnings, after earnings have been indexed for wage growth over time.

Adequacy: The benefit supplement option targets lifetime low earners, generally women, who never married or were not married long enough to qualify for spousal benefits. Low-income single and divorced women are expected to benefit most from this option. While some retirement experts are supportive of this option because it focused on the needs of low-income women, others questioned the rationale for basing eligibility on marital status and said either that eligibility for the supplement should be expanded to a broader group of beneficiaries or that the needs of low-income single women could be addressed through another option, such as a guaranteed minimum benefit.

Solvency: Because a benefit supplement for low-income single workers increases benefits, it has cost implications for Social Security's solvency. The extent to which this option affects solvency will depend largely on the number of people who would be eligible for it. A key factor that directly influences the number of eligible beneficiaries is the multiple that would be applied to a worker's AIME, ranging from 150 percent to 300 percent. Another factor that could influence cost is the way "single" is defined for purposes of determining eligibility.⁶⁵

Administration: Agency officials and retirement security experts told GAO that determining an individual's single status could be administratively complex because people's marital statuses change over time and could change after an initial determination is made, for example, from single to married.

Option: Adopting Earnings Sharing

Earnings sharing combines married individuals' annual earnings and evenly divides them between the two spouses for each year of marriage when calculating individuals' Social Security retirement benefits. Each spouse accrues credits toward an individual benefit, even if only one of them worked. An earnings sharing approach is often proposed as an alternative to or an adjustment of existing spousal and survivor benefits. For example, under earnings sharing, divorced spouses whose marriages lasted less than 10 years would be entitled to the individual benefits accrued during the marriage. This option is also seen as a way to equalize benefits received by dual-earner married couples with those of single-earner couples. Currently, a single-earner couple receives higher total benefits than a dual-earner couple with the same total lifetime earnings. Under some earnings sharing, the total benefit amount a single-earner couple receives would be the same as the amount received by a dual-earner couple who makes the same total income, rather than 150 percent of the worker's benefit. Over the years, analysts have proposed an extremely wide range of earnings sharing proposals, which treat spouse and survivor benefits in markedly different ways (some eliminate these benefits altogether, others develop various survivor adjustments, others impose self-financing of survivor benefits, and others direct cost savings toward higher worker benefits). Such details make large differences in the proposals' costs and distributional effects.

⁶⁵ One proposal that includes this option defines marital status at the time when a person first applies for Social Security retirement benefits and includes a provision to address changes in status after that time. See Patricia E. Dilley, "Restoring Old Age Income Security for Low Wage Single Workers," National Academy of Social Insurance (2009), available at http://www.nasi.org/sites/default/files/research/Patricia_Dilley_January_2009_Rockefeller.pdf.

Adequacy: Earnings sharing targets divorced spouses, generally women, whose marriages were too short to qualify them for spouse or survivor benefits and whose incomes while married were lower than their spouses' incomes. Some retirement security experts and agency officials said earnings sharing could increase benefits for divorced women. Proponents of this option also focus on it as a means to improve equity between single earner and dual-earner married couples. However, other experts said this option would not do much to improve benefits for economically vulnerable beneficiaries, in part, because it is not well targeted. For example, SSA's simulations found that earnings sharing would decrease benefits for the majority of future retirees, although benefits for some would increase.⁶⁶ Specifically, benefits would decrease for about 50 percent of divorced women and increase for about 40 percent of divorced women. Benefits would also increase for over one-third of married individuals, but decrease for the vast majority of widow(er)s.

Solvency: Because earnings sharing would increase benefits for some but decrease them for others, its net impact on Social Security's solvency is unclear. Its cost would depend on the relative numbers of people whose benefits increase or decrease and the amounts of those changes. In addition, cost will be affected by future demographic trends regarding marriage, workforce participation, and related variables.

Administration: The extent to which this option increases SSA's workload depends on the number of newly eligible people who would receive benefits, which will be influenced by future trends in marriage and workforce participation. Some additional administrative effort and cost would also be required to transition from the current system's spousal benefit to an earnings sharing approach, in part because of the need to verify marriage and divorce data.

Option: Reducing the Marriage Duration Required for Spousal Benefits

Reducing the number of years a marriage must have lasted for a divorced person to receive spousal benefits addresses benefit adequacy by increasing the number of people who are eligible to receive Social Security spousal benefits. Proponents of this option note that reducing the marriage requirement from ten to seven years would reflect current trends for shorter marriages.⁶⁷ One Social Security proposal suggests that reducing the required marriage duration could be combined with a minimum work requirement for the divorced spouse. Combining at least seven years of marriage with a minimum of three years of work would mimic the standard 10-year work requirement for Social Security retirement benefits.

Adequacy: Reducing the marriage duration required for spousal benefits is an option that targets divorced spouses, generally women, whose marriages were too short to qualify them for benefits. One retirement security expert said that this option would be an improvement over

⁶⁶ Benefit reductions would be more widespread for married individuals in single-earner couples, and benefit increases would be more prevalent for those in dual-earner couples. See Iams, et al., "Earnings Sharing in Social Security: Projected Impacts of Alternative Proposals Using the Mint Model," *Social Security Bulletin*, vol. 69, no. 1 (2009), available at <http://www.ssa.gov/policy/docs/ssb/v69n1/v69n1p1.pdf>.

⁶⁷ According to the Census Bureau, the median duration of first marriages that ended in divorce was eight years in 2001.

the current 10-year requirement and other experts and agency officials said it would help address benefit adequacy for women. However, experts also said they do not expect this option to effectively target economically vulnerable groups. This option would not benefit women who were never married but could benefit higher-income women who are not economically vulnerable.

Solvency: The extent to which this option affects solvency depends on how many people would become eligible with a shorter marriage requirement.⁶⁸ Increased eligibility will depend on the way the option is designed. For example, not including a corresponding work requirement would increase costs more because people who have no work history would also be eligible. In addition, cost will be affected by future demographic trends regarding marriage.

Administration: The extent to which this option increases SSA's workload depends on the number of newly eligible people who would receive spousal benefits, which will be influenced by future trends in marriage and workforce participation.

Option: Providing Caregiver Credits

Providing caregiver credits increases benefits for those who spend time out of the workforce to care for dependent children or elderly relatives. Time spent out of covered employment as a caregiver may reduce benefits for workers, and others may not work enough to earn the required 40 credits to be eligible for benefits.

A caregiver credit option can be designed in different ways. One design allows a specified amount of caregiving time, such as three or four years, to count as covered employment, and assigns a wage to that time. For example, an average wage for all workers could be assigned or a wage linked to an individual beneficiary's prior earnings could be used. Another design excludes a limited number of caregiving years from the benefit calculation so that instead of averaging earnings over 35 years, earnings are averaged over fewer years. A final design supplements caregivers' retired worker benefits directly, regardless of whether they took time out of the workforce for caregiving. For example, an income-tested supplement could be given to increase retired worker benefits by 75 percent for those who have one child and 80 percent for those with two or more children. Both parents of a child would be eligible for this supplement, as long as the total household income did not exceed 125 percent of the federal poverty line.⁶⁹

Adequacy: Caregiver credits seek to improve benefit adequacy for workers, primarily women, who have shorter earnings records because they spent time providing care for children or elderly relatives and do not qualify for spousal benefits because they never married or were not married long enough to qualify for them. Retirement security experts said this option

⁶⁸ In prior work, GAO found that very few people would be newly eligible for benefits if the marriage duration were reduced to 7 years. See GAO, *Retirement Security: Women Face Challenges in Ensuring Financial Security in Retirement*, GAO-08-105 (Washington, D.C.: Oct. 11, 2007), available at <http://www.gao.gov/new.items/d08105.pdf>.

⁶⁹ The credit would remain income tested if the parents are living apart.

recognizes the societal value of caregiving, but experts also said that, for various reasons, it may not reach its target population. For example, some low-income people are unable to take time off from work. Therefore, people who have relatively higher incomes may benefit more from the creation of caregiver credits. Effects would vary greatly based on the credits' design. For example, capping the credit at half the average wage for caregiving years would provide more benefits for high income families.

Solvency: Because caregiver credits increase benefits they have cost implications for Social Security's solvency. The extent to which this option affects solvency depends largely on who would be eligible to receive the credit: one or both parents, all caregivers, or just those who have low incomes. Extending eligibility to a greater number of people will increase costs. In addition, the number of years that credits may be received and the wage assigned to those years will impact costs.

Administration: Retirement security experts and SSA officials told GAO that caregiver credits would be complex to administer. A key issue is how to verify that care was provided to a qualifying person. Experts said a birth certificate could be used to document child care, but elder care would be more burdensome to document. Measuring time off and verifying that caregiving actually occurred would also be difficult.

Option: Increasing Survivor Benefits

Increasing benefits for surviving spouses, often widowed women, by providing a Social Security retirement benefit equal to 75 percent of the combined amount the couple received addresses concerns about benefit adequacy. The current benefit structure decreases household income upon widowhood by one-third if the couple's benefits had been based on one spouse's work history and up to 50 percent if both spouses had been receiving retired worker benefits. Increasing survivor benefits would lessen the magnitude of this change.

Adequacy: Increasing survivor benefits is an option that targets widowed women, although widowed men could also benefit. Retirement security experts and agency officials said this option could address benefit adequacy for a vulnerable group and would be an improvement over the current system. They also said that this option can be targeted specifically toward low-income survivors, for example, by including a cap. Experts and agency officials also said this option addresses equity concerns by increasing benefits for dual-earner couples. Under the current system, dual-earner couples experience a proportionally greater decrease in benefits upon the death of a spouse than single-earner couples experience. However, as some experts noted, this option could increase the disparity between benefits for women who do not qualify for spousal or survivor benefits relative to those that do qualify.

Solvency: Increasing survivor benefits will have implications for Social Security's solvency. The extent to which this option increases costs depends on how much greater the benefit amount is across all eligible survivors. Capping the amount of the increase based on income could help moderate costs. Some proposals also combine this option with a reduction in spousal benefits to help finance the increase in survivor benefits so it is cost neutral or has a very small affect on solvency.

Administration: Agency officials told GAO that this option could be complex to administer, in part because it uses a “couple’s benefit” as a baseline for calculating survivor benefits. Since such a benefit does not currently exist in the Social Security system this could be problematic, for example, in cases where one of the spouses dies before retiring. In addition, officials said there are many complicated rules for survivors because of an existing provision, called the widow(er)’s limit, that caps benefit amounts for some survivors.⁷⁰ Benefit increases expected under this option could be negated by this provision. To avoid this result, one proposal⁷¹ would use the deceased spouse’s full PIA in the calculation of the couple’s benefit, without any reduction because the deceased spouse claimed benefits before the FRA, and would increase disparities.

Option: Providing Longevity Insurance

Providing longevity insurance addresses concerns about benefit adequacy by increasing Social Security retirement benefits for beneficiaries who reach an advanced age, such as 80 or 85. As people grow older, they risk outliving their other resources, become less able to work, and become more dependent on Social Security benefits for their income. Longevity insurance seeks to reduce the risk that they fall into poverty at older ages by increasing their Social Security benefits.

This option could be targeted specifically toward low-income beneficiaries, or provided to all those who reach an advanced age. Work history could be an additional condition for eligibility. For example, one longevity insurance proposal increases benefits for people who have low benefits at age 82 and have at least 20 years of covered employment. It would provide a minimum benefit equal to 70 percent of the federal poverty line for a 20-year worker and increases the benefit for each additional year of work. Another proposal increases benefits by 10 percent at age 85 for 30-year workers whose benefits are lower than 75 percent of the average benefit all workers receive.⁷²

Adequacy: Providing longevity insurance targets the oldest Social Security beneficiaries. Retirement security experts believe this could be an effective option for addressing concerns about benefit adequacy for the very old, especially the oldest widows, because women generally live longer than men. However, some experts also said that unless this option is specifically targeted toward low-income beneficiaries, most of the benefits would accrue to higher-income people because they tend to live longer. In addition, agency officials said this option could create disincentives to save for retirement or incentives to spend down resources before beneficiaries become old enough to qualify for the longevity increase. By doing so, those whose assets would be too high to satisfy the means test could become eligible for the increase.

⁷⁰ 42 U.S.C. § 402(f)(2); (f)(3) and (q).

⁷¹ Joan Entmacher, “Strengthening Social Security Benefits for Widow(er)s: The 75 Percent Combined Worker Benefit Alternative,” January 2009, available at <http://www.nasi.org/research/2009/strengthening-social-security-benefits-widowers-75-percent>.

⁷² This proposal presents different options for implementing the increase, for example, adding the supplement to the cost-of-living adjustment each year.

Solvency: Providing longevity insurance would increase Social Security program costs. Key factors that influence costs include the age at which the benefit increases, the amount of the increase, and whether all beneficiaries or only low-income ones are eligible to receive the benefit. Providing the benefit at an earlier age, for example, at 80 instead of 85, would increase costs, as would providing it to all 80-year-olds instead of only those who are low income. Unless the proposal adjusts to increases in life expectancy, costs would increase in the future. A proposal that increased benefits by one percent for each year a beneficiary lived beyond their average life expectancy, so that beneficiaries who lived 10 years longer than life expectancy would have a 10 percent higher benefit, would cost 0.08 percent of taxable payroll.

Administration: This option would not increase the number of beneficiaries SSA serves and could use existing information to determine eligibility, and retirement security experts and agency officials said that this option would be easy to administer. However, one expert said adding measures to improve targeting would increase administrative complexity.

Benefit Adequacy Options Could Reduce Other Benefits for Vulnerable Groups, but Approaches to Mitigate These Effects are Available

Many Social Security retirement beneficiaries receive benefits from other federal programs. Nine percent of Social Security beneficiaries age 65 or older, or more than 2.7 million people, also receive Supplemental Security Income (SSI), Medicaid, or Supplemental Nutrition Assistance Program (SNAP) benefits.⁷³ Increasing Social Security benefits to address concerns about adequacy for vulnerable groups of beneficiaries could result in a decline in benefits from these other programs. In fact, some beneficiaries could lose eligibility for benefits from the other programs altogether. On the other hand, some beneficiaries may not be affected because their incomes, even with increased Social Security benefits, would stay within the other programs' eligibility limits.

Supplemental Security Income

An increase in Social Security retirement benefits could cause some SSI recipients to receive lower SSI benefits, although the total amount from both sources could remain constant or even increase. Some recipients would lose SSI eligibility altogether if their income, including their enhanced Social Security benefits, exceeded the SSI income eligibility standards. Every additional dollar of Social Security benefits, beyond the first \$20,⁷⁴ results in a dollar-for-dollar reduction in SSI benefits. This trade-off results in no net loss of benefits from these two sources. However, there could be a loss of SSI eligibility if the Social Security benefit increase causes earned and unearned income, after disregards, to exceed the maximum allowable SSI benefit, or \$674 per month in 2010.⁷⁵ Assuming no other sources of income, an SSI recipient who currently

⁷³ For purposes of this analysis, GAO specifically examined Social Security beneficiaries who receive retirement, spousal, or survivor benefits.

⁷⁴ The \$20 amount is a general SSI income exclusion that was set in the original law, and has not been updated.

⁷⁵ For couples receiving SSI, the maximum allowable payment in 2010 is \$1,011. Some states offer supplements to the federal SSI payment, which allow those with incomes above federal limits to qualify for SSI.

receives \$693 per month from Social Security alone or both programs combined retains SSI eligibility, but an SSI recipient whose Social Security benefit exceeds \$693 per month loses SSI eligibility (see **Table 11**).

TABLE 11: EXAMPLE OF HOW SSI ELIGIBILITY RELATES TO AN INDIVIDUAL'S INCOME

Social Security Benefits	\$620	\$693	\$694
Less income disregard	-20	-20	-20
Total countable income for SSI	600	673	674
<i>SSI eligible?</i>	<i>Yes</i>	<i>Yes</i>	<i>No</i>
SSI benefits	74	1	0
Total income	694	694	694

Source: GAO analysis of SSI eligibility requirements.

Losing SSI eligibility also closes one pathway to Medicaid eligibility for some individuals, although individuals may be able to keep their Medicaid coverage under other rules. Many experts said losing Medicaid eligibility is more detrimental to beneficiaries than losing SSI eligibility. Some beneficiaries would be harmed rather than helped because the loss of Medicaid coverage and the subsequent increase in out-of-pocket health care costs could significantly outweigh the Social Security benefit increase. Similarly, losing SSI eligibility also eliminates a pathway to SNAP eligibility for some households, but these households may still qualify for SNAP benefits based on net income.

There are also reasons why some beneficiaries may prefer Social Security benefits to SSI benefits. Several retirement security experts said there may be a stigma associated with SSI that deters people from participating because it is viewed as welfare, while Social Security is tied to income earned through work. In addition, Social Security benefits do not require the income and asset testing that SSI benefits do, reducing the application burden for beneficiaries. SSA officials said applicants may consider that burden a deterrent to applying, especially if their potential SSI benefit is small. Because people may choose not to apply for SSI, some experts suggest that Social Security may more effectively target vulnerable populations.

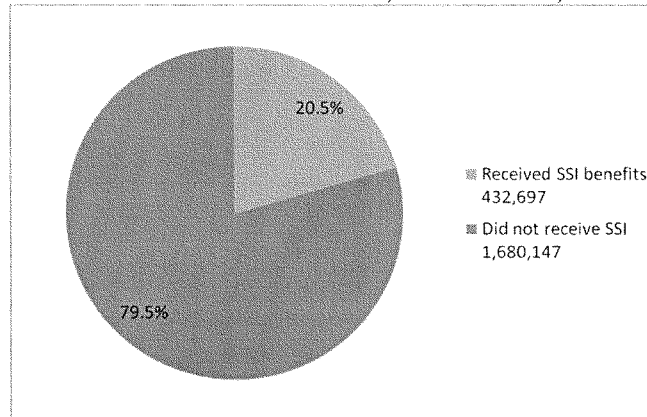
Medicaid

For some beneficiaries, Medicaid coverage is linked to their receipt of SSI, which puts them at risk of losing Medicaid if they lose SSI because their Social Security benefits increase.⁷⁶

⁷⁶ Medicaid is a joint state and local means tested program that finances health care coverage for certain categories of low-income individuals, including those age 65 and older.

However, those who lose their SSI benefits may be able to retain their Medicaid coverage under alternative state eligibility criteria.⁷⁷ For example, they may still be eligible to retain Medicaid coverage if their income is low enough or if they qualify under state rules as “medically needy.” In 2007, about one-fifth of the more than 2 million Social Security beneficiaries who received Medicaid also received SSI benefits, and the other four-fifths were eligible for Medicaid under other criteria (see **Figure 9**).

FIGURE 9: SOCIAL SECURITY BENEFICIARIES, AGE 65 OR OLDER, PARTICIPATING IN MEDICAID, BY SSI STATUS, 2007



Source: GAO analysis of U.S. Census Bureau data.

Note: Data refer to Social Security beneficiaries who reported receiving retirement, spousal, or survivor benefits.

Medicaid beneficiaries whose income increases to the level where they are no longer eligible for all Medicaid benefits may still qualify for assistance with Medicare premiums, cost-sharing, or both. However, under these circumstances, certain benefits that may be covered by Medicaid, such as dental, vision and long-term care services, would no longer be covered.⁷⁸ The amount of assistance with Medicaid premiums and cost-sharing for which beneficiaries may qualify is based on several factors, including income levels and states’ policies. For example, states are required to provide assistance for Medicare premiums and cost-sharing to beneficiaries with incomes at or below 100 percent of the federal poverty line.⁷⁹ For individuals with higher incomes, states may vary in the amount of premium and cost sharing assistance they provide.

⁷⁷ Because eligibility standards for Medicaid can vary by state, an individual’s option for coverage may be affected by where he or she lives.

⁷⁸ Medicare does not provide coverage for these services.

⁷⁹ Beneficiaries must also have resources that are at or below an established level to qualify for this assistance.

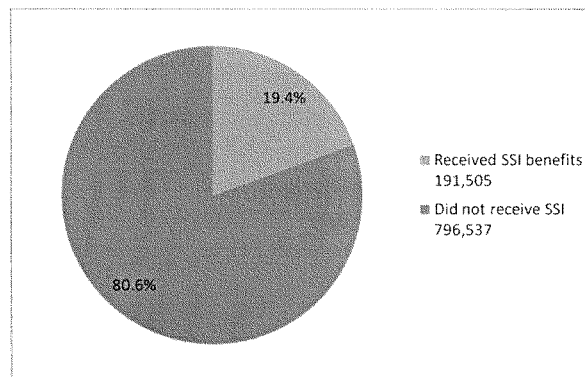
In general, because Medicaid eligibility requires beneficiaries to meet some sort of income test, an increase in Social Security benefits could cause those near these income limits to lose their Medicaid benefits entirely. The amount of the increase that would result in a loss of Medicaid may vary among states, because they have discretion to set income limits above federal mandatory minimums and other eligibility criteria.

While Social Security beneficiaries who lose Medicaid would still have Medicare coverage, some beneficiaries could still incur significant out-of-pocket health care expenses.⁸⁰ Researchers have found that individuals who qualify for both Medicare and Medicaid tend to have very low incomes and experience serious and costly health conditions, such as heart disease.

Supplemental Nutrition Assistance Program

An increase in Social Security benefits could cause a loss of Supplemental Nutrition Assistance Program (SNAP) eligibility for some beneficiaries.⁸¹ In all states except California, households in which all members receive SSI qualify for SNAP without meeting an income test.⁸² If SSI eligibility is lost, beneficiaries may still qualify under SNAP's income eligibility rules. In 2007, about 81 percent of Social Security beneficiaries who received SNAP benefits qualified for them under the program's rules, rather than through SSI, as illustrated in **Figure 10**.

FIGURE 10: SOCIAL SECURITY BENEFICIARIES, AGE 65 OR OLDER, PARTICIPATING IN SNAP, BY SSI STATUS, 2007



Source: GAO analysis of U.S. Census Bureau data.

Note: Data refer to Social Security beneficiaries who reported receiving retirement, spousal, or survivor benefits.

⁸⁰ In 2007, all Social Security beneficiaries age 65 and older received Medicare benefits.

⁸¹ Supplemental Nutrition Assistance Program, formerly known as the Food Stamp Program, is a means-tested food assistance program designed to help low-income households with food purchases.

⁸² California converted SNAP benefits to cash included in state supplementary payments.

SNAP's eligibility rules are based on income limits that are generally higher than those of SSI, and SNAP limits vary by household size, as shown in **Table 13**.⁸³ Households with an elderly person must meet net income limits but not gross income limits to qualify for SNAP. Under current rules, an elderly individual living alone whose net monthly income exceeds \$903 would not be eligible for SNAP benefits.⁸⁴ Therefore, if an elderly individual whose net monthly income is close to the income limit receives a large enough increase in Social Security benefits he or she may no longer meet the income test for SNAP and lose all SNAP benefits. For example, if Social Security benefits are increased by \$104 for an individual currently receiving \$800, total income would increase to \$904, and they would lose SNAP eligibility.

TABLE 13: FISCAL YEAR 2010 SNAP INCOME LIMITS FOR HOUSEHOLDS WITH AN ELDERLY MEMBER

Size of Household	One	Two	Three	Four	Five	Six	Seven	Eight	Additional Members
Net monthly income	\$903	\$1,215	\$1,526	\$1,838	\$2,150	\$2,461	\$2,773	\$3,085	+\$312 each

Source: U.S. Department of Agriculture, Food and Nutrition Service.

Note: Households with an elderly person must meet net income limits, whereas other households must meet net and gross income limits. Income limits are higher in Alaska and Hawaii.

Although an increase in Social Security benefits could prompt a reduction in SNAP benefits, the total benefits received would increase. SNAP benefits are reduced by 30 cents for every additional dollar of Social Security, unless the increase becomes large enough to raise total income above the SNAP eligibility limit. For example, an individual whose net monthly income is \$500 could currently qualify for \$50 in SNAP benefits (see **Table 14**). If the individual's monthly Social Security income increased by \$100, raising net monthly income to \$600, SNAP benefits would decline to \$20 per month. However, total monthly income would increase by \$70, from \$550 to \$620 per month.

TABLE 14: EXAMPLE OF HOW SNAP ELIGIBILITY RELATES TO AN INDIVIDUAL'S INCOME

Monthly net income	\$500	\$600
(A) Maximum monthly SNAP allotment	200	200
(B) Net monthly income multiplied by 30 percent	150	180
SNAP benefits (A-B)	50	20

⁸³ Households where all members receive Temporary Assistance for Needy Families, or in some places, general assistance (benefits for low-income individuals who are not eligible for federal assistance) do not need to meet separate income limits to qualify for SNAP.

⁸⁴ Net income limits are higher in Alaska and Hawaii. In determining net income, households in all states are allowed to make certain deductions.

Total Income	\$550	\$620
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Source: GAO analysis of SNAP eligibility requirements.

As with SSI, beneficiaries may prefer to receive benefits through Social Security instead of SNAP. Several retirement security experts said there may be a stigma associated with SNAP because it is viewed as a welfare program, while Social Security is tied to income earned through work, though stigma may be mitigated when SNAP benefits are provided via debit card. Additionally, unlike Social Security, SNAP benefits are subject to income and asset tests, which can create a burden for applicants and deter participation. Finally, beneficiaries may prefer the flexibility of Social Security, a cash benefit, to SNAP benefits, which are provided as grocery credits and restricted to food purchases.

Steps Could Be Taken to Mitigate Potential Benefit Reductions

Retirement security experts suggested several ways to mitigate the potential loss of benefits from other programs as a result of an increase in Social Security benefits for vulnerable groups. Each of these approaches would entail trade-offs, including additional costs and administrative effort for the affected programs. Depending on the scope and provisions of each option when implemented, these approaches could also increase states' Medicaid caseloads and have a significant effect on their budgets.

- Increasing the SSI general income disregard of \$20 would let SSI recipients receive more Social Security before losing SSI eligibility.
- Increasing the maximum allowable SSI benefit would also enable SSI recipients to receive more Social Security before losing SSI eligibility.
- Creating a Social Security exclusion in SSI would allow income from Social Security to be disregarded when calculating SSI benefits.
- Deeming those who qualify for SSI under current rules to be eligible for Medicaid would also allow those who would otherwise lose SSI eligibility to retain Medicaid coverage. The so-called "Pickle Amendment" allows those formerly eligible for SSI to maintain SSI eligibility, at a benefit level of zero dollars, for the purpose of receiving Medicaid if they become ineligible as a result of Social Security cost-of-living adjustments.⁸⁵ A similar approach could be used if beneficiaries become ineligible for Medicaid as a result of an increase to Social Security benefits for vulnerable groups.
- Disregarding increased Social Security benefits in determining Medicaid eligibility would allow those who would otherwise lose Medicaid to retain their coverage. There is some precedent for this approach: individuals who meet certain criteria currently can

⁸⁵ Pub. L. No. 94-566, § 503 codified at 42 U.S.C. § 1396a

continue to receive Medicaid even if their earned income becomes too high to qualify for SSI benefits. However, this existing provision applies only to those who need Medicaid to work.⁸⁶

- Although Medicaid already has other eligibility pathways that are income-based and not linked to SSI, breaking the direct link between SSI and Medicaid eligibility would prevent a loss of SSI from affecting Medicaid benefits. One expert suggested using a program with a higher income limit than SSI, such as SNAP, to test income eligibility for Medicaid. Other experts said that if the income limit for Medicaid were tied to some multiple of the federal poverty line, such as 100 percent or 133 percent, more Medicaid beneficiaries would retain coverage, despite increases in Social Security benefits.

⁸⁶ 42 U.S.C. § 1382h(b). To qualify, a person must have been eligible for SSI for at least 1 month, still meet the disability and nondisability requirements, need Medicaid in order to work, and have gross earned income that is either below a predetermined state threshold or below an individualized threshold.

Conclusion

For nearly 75 years, the Social Security program has served as the foundation of retirement income for American workers and their families. Yet Social Security is much more than just a retirement program; it provides benefits to survivors and other dependents as well as to disabled workers. Even though the program currently boasts large Trust Funds, an aging American population, a decline in the birthrate, and an increase in life expectancy will soon place a financial strain on Social Security. Congress should tackle this issue soon, while only minor changes to the system are needed.

This report presents several options for increasing the long term solvency of Social Security, and provides estimates of the impacts of these efforts on the Social Security Trust Funds. However, these estimates have several limitations that deserve careful consideration. First, these estimates are provided with the assumption that all other elements of Social Security remain the same. Because many of the reforms would interact with each other, the estimated impacts on solvency of two or more options cannot simply be summed to estimate their impact if they were to be implemented simultaneously, and need to be recalculated. Similarly, these estimates are based on a particular timing of their implementation. Combining options or changing the timing would require new estimates to predict their effects on solvency. Further, options to increase solvency may not impact everyone in the same way - some recipients may see their Social Security taxes and benefits change, while others may not. The impacts of proposals should be examined for both current beneficiaries and future generations of retirees, as many options phase in over time.

Social Security solvency and effectiveness are separate factors, but should be analyzed together. Efforts to improve solvency may enhance, weaken, or have no impact on Social Security's current level of effectiveness in providing retirement security for all Americans. Improving the adequacy of benefits for vulnerable populations may also have a cost to implement. In short, a full consideration of any group of options requires a thorough analysis to predict their effects on solvency and adequacy.

Modernizing Social Security means ensuring that the program is both solvent and effective, for all Americans, now and in the future. This is a complex task that will become increasingly difficult as the Social Security Trust Funds diminish. Congress will have to address the twin challenges of solvency and effectiveness simultaneously, and because the program is critical to every American family, it should be done in a bipartisan and transparent way.

APPENDIX

House and Senate Budget Procedures to Protect Social Security Balances

The rules to ensure that legislation considered by Congress does not negatively affect the Social Security Trust Funds balances differ between the House and the Senate.

In the House, a point of order (i.e., a floor objection) may be raised against a bill that proposes more than \$250 million in Social Security spending increases or tax cuts over five years (counting the fiscal year it becomes effective and the following four years) unless the bill also contains offsetting changes to bring the net impact within the \$250 million limit. Costs of prior legislation that fall within the five-year period must be counted. A point of order also may be raised against a measure that would increase long-range (75-year) average costs or reduce long-range revenues by at least 0.02 percent of taxable payroll.

In the Senate, the annual congressional budget resolution must include separate amounts for Social Security Trust Fund revenues and outlays for each year covered by the resolution (i.e., separate from the budget totals). These amounts must reflect surpluses of the Social Security Trust Funds that are not less than those projected under current law. Once the resolution is adopted by Congress, subsequent measures that would be projected to cause Social Security Trust Funds' surpluses to be lower (or deficits to be higher) than those reflected in the amounts in the budget resolution are subject to a point of order. A motion to waive the point of order requires an affirmative vote of three-fifths of Senators (i.e., 60 Senators if there are no vacancies).

These rules do not prevent Congress from considering legislation that is projected to increase or reduce the receipts and disbursement levels of the Social Security Trust Fund. Instead, the rules require that the net effect of such changes do not negatively affect the balances of the Social Security Trust Funds. Congress, however, is prohibited from including any changes to the Social Security program in reconciliation legislation, which is considered under expedited procedures. As a result, Congress must consider changes to the Social Security program separate from other budgetary legislation.

In addition, both the House and Senate have "pay-as-you-go" (PAYGO) requirements for revenue and mandatory spending legislation (Social Security disbursements are a form of mandatory spending). The House and Senate PAYGO rules prohibit the consideration of revenue and direct spending legislation that would have the net effect of increasing the deficit over either a six-year period or an 11-year period, respectively. The House PAYGO rule applies to legislation affecting the unified budget deficit, which includes the receipts and disbursements of the Social Security Trust Funds. The Senate PAYGO rule, however, applies to legislation affecting the on-budget deficit, which excludes the Social Security Trust Funds.

GLOSSARY OF KEY TERMS

Annuity—an insurance product that provides a stream of payments for a pre-established amount of time in return for a premium payment. For example, a life annuity provides payments for as long as the annuitant lives. Only insurance companies can underwrite annuities in the United States. Other financial intermediaries, such as banks and stock brokerage firms, may sell annuities issued by insurance companies.

Average Indexed Monthly Earnings—the average monthly earnings received over a worker's career, adjusted yearly by the change in national average earnings. It is the dollar amount used to calculate Social Security benefits for individuals who attain age 62 or become disabled (or die) after 1978. To arrive at the AIME, SSA adjusts a person's actual past earnings using an "average wage index," so he or she does not lose the value of past earnings in relation to more recent earnings. For people who attained age 62 or became disabled (or died) before 1978, SSA uses Average Monthly Earnings (AME).

Baseline—a measurement that serves as a basis against which all following measurements are compared.

Consumer Price Index (CPI)—a measure of the change over time in the prices, inclusive of sales and excise taxes, paid by urban households for a representative market basket of consumer goods and services. The CPI is prepared by the U. S. Department of Labor and used to compute COLA increases.

Contribution and Benefit Base—the cap on taxable earnings used to fund Social Security. The cap, also called the taxable maximum wage or taxable wage base, limits the earnings that can be used in the benefit formula and, therefore, limits the size of benefits. The cap limits the program's costs and the payroll taxes that pay for them. Limiting the size of benefits reflects the program's role of only providing for a floor of protection.

Cost-of-Living Adjustment (COLA)—an increase or decrease in wages or benefits according to the change in the cost-of-living as measured by some statistical measure, often the Consumer Price Index (CPI). Social Security benefits and Supplemental Security Income payments are increased each year to keep pace with increases in the cost-of-living (inflation), as measured by the CPI.

Covered Earnings—earnings from a job which requires contributions to the Social Security program. (See *covered worker* for more information.) All covered earnings below the taxable wage base—that is, *taxable earnings*—are subject to Social Security *payroll taxes*. Covered earnings above the taxable wage base are exempt from the Social Security payroll tax.

Covered Worker—workers in covered employment, that is, jobs through which the workers have made contributions to Social Security.

Credits—to be *insured* for retired *worker benefits*, an individual must accumulate at least 40 credits in the Social Security system, which is equivalent to at least 10 years of covered employment. In 2006, a worker received one credit (up to a total of four per year) for each \$970 in *covered earnings*. Fewer credits may be required in some survivor and disability cases; in these cases, benefits may be granted with as few as six credits. The amount of earnings required for a credit is *wage indexed*.

Deficit—the amount by which the government’s spending exceeds its revenues in a given period, usually a fiscal year. The federal deficit is the shortfall created when the federal government spends more in a fiscal year than it receives in revenues. To cover the shortfall, the government sells bonds to the public.

Defined Benefit—a type of retirement plan that guarantees a specified retirement payment at a certain age and after a specified period of service. Defined benefit plans promise their participants a steady retirement income, generally based on years of service, age at retirement, and salary averaged over some number of years. Defined benefit plans express benefits as an annuity, but may offer departing participants the opportunity to receive lump sum distributions. Defined benefit plans are one of two basic types of employer-sponsored pension plans.

Defined Contribution—a type of retirement plan that establishes individual accounts for employees to which the employer, participants, or both make periodic contributions. Defined contribution plan benefits are based on employer and participant contributions to and investment returns (gains and losses) on the individual accounts. Employees bear the investment risk and often control, at least in part, how their individual account assets are invested. Defined contribution plans are one of two basic types of employer-sponsored pension plans.

Delayed Retirement Credit—an increase to the *primary insurance amount (PIA)* if a beneficiary delays claiming Social Security benefits beyond his or her *full retirement age (FRA)*. The amount of the increase varies depending on the beneficiary’s date of birth and how long a beneficiary delays benefit take-up beyond his or her FRA. However, the increase stops when a person reaches age 70, even if he or she continues to delay taking up benefits.

Dependent—a person who is eligible for benefits or care because of his or her relationship to an individual. Under the Social Security Act, “dependent” means the same as it does for federal income tax purposes; i.e., someone for whom the individual is entitled to take a deduction on his personal income tax return, generally an individual supported by a tax filer for over half of a calendar year.

Disabled—disability under Social Security is based on the inability to work. The definition of disability under Social Security is different than under other programs. SSA considers a person disabled under Social Security rules if the person cannot do work that he or she did before and SSA decides that the person cannot adjust to other work because of his or her medical condition(s). A person’s disability must also last or be expected to last for at least 1 year or to result in death. Social Security pays only for total long-term disability. No benefits are payable for partial disability or for short-term disability. Social Security program rules assume that

working families have access to other resources to provide support during periods of short-term disabilities, including workers' compensation, insurance, savings, and investments.

Dually Entitled—workers who qualify for Social Security benefits from both their own work and their spouses'. Such workers do not receive both the benefits earned as a worker and the full spousal benefit; rather, the worker receives the higher amount of the two.

Early Retirement Age (early eligibility age)—the age at which individuals qualify for reduced retirement benefits if they choose to collect benefits before the normal retirement age; the current early retirement age for Social Security is 62. Individuals who choose to take retirement benefits early will have their monthly benefits permanently reduced, based on the number of months they receive checks before they reach full retirement age.

Earnings—Wages or self-employment income. Also see *covered earnings* and *taxable earnings*.

Eligibility—conditions that must be met for participation. To be eligible for Social Security retirement benefits, everyone born in 1929 or later needs 40 credits. Since a worker can earn 4 credits per year, he or she needs at least 10 years of work that is subject to Social Security to become eligible for Social Security retirement benefits. Each year, the amount of earnings needed for a credit rises as the average earnings levels rise. In 2005, a worker receives 1 credit for each \$920 of earnings, up to the maximum of 4 credits per year.

Entitlement—a federal program or provision of law that requires payments to any person or unit of government that meets the eligibility criteria established by law. Social Security, Medicare, Medicaid, and veterans' compensation are examples of entitlement programs. Entitlements leave no discretion with Congress on how much money to appropriate, and some entitlements carry permanent appropriations.

Equity, including Intergenerational—the goal to ensure that the costs and benefits of Social Security bear some relationship to contributions and that a much greater burden is not placed on certain specific groups, including certain generations of workers.

Federal Insurance Contributions Act (FICA) taxes—see payroll tax.

Full Retirement Age (FRA) (Also called normal retirement age.)—the age at which individuals qualify for full, or unreduced, retirement benefits from Social Security and employer-sponsored pension plans. The normal retirement age for Social Security was 65 for many years. Beginning with year 2000 for workers and spouses born 1938 or later and widows/ widowers born 1940 or later, the normal retirement age increases gradually from age 65 until it reaches age 67 in the year 2022.

Fully Funded—a system that is fully funded, or "advance funded," is one in which sufficient contributions are put aside each year to pay for future benefits when they come due. Defined contribution pensions and individual retirement accounts are fully funded by definition.

Gross Domestic Product—a commonly used measure of total domestic national income. GDP measures the market value of total output of final goods and services produced within a country's territory, regardless of the ownership of the factors of production involved, i.e., local or foreign, during a given time period, usually a year. Earnings from capital invested abroad (mostly interest and dividend receipts) are not counted, while earnings on capital owned by foreigners but located in the country in question are included. GDP may be expressed in terms of product—consumption, investment, government purchases of goods and services, and net exports—or it may be expressed in terms of income earned—wages, interest, and profits. It is a rough indicator of the economic earnings base from which government draws its revenues.

Income Adequacy—in Social Security's history, "adequacy" has never been explicitly defined. However, the Congress expected that Social Security benefits would eventually provide more than a "minimal subsistence" in retirement for full-time, full-career workers. Various measures help examine different aspects of this concept, but no single measure can provide a complete picture. Such measures include poverty rates, replacement rates, and the proportion of the population that depends on others for income support.

Inflation (Prices)—a rate of increase in the general price level of all goods and services. The official measure of inflation in the United States is the *Consumer Price Index*.

Indexation (See Price Indexation, Wage Indexation.)

Insolvency—in the context of Social Security, the inability of the Trust Funds to pay all current expenses out of current tax income and accumulated Trust Fund assets. Insolvency would mean that Social Security's Trust Funds were unable to pay full benefits on time. (Insolvency would not mean that Social Security would be completely broke and unable to pay any benefits.)

Insured—in the context of Social Security, having enough *credits* to meet eligibility requirements for retired or *disabled* worker benefits, or to permit the worker's spouse and children or survivors to establish eligibility for benefits in the event of the worker's retirement, disability, or death.

Intermediate Assumptions—the Social Security Administration actuaries' "best estimate" of future demographic and economic trends. The actuaries also produce high cost (pessimistic) assumptions and low cost (optimistic) assumptions. These assumptions are published annually in the Social Security Trustees Report.

Life Expectancy—an estimate of the average remaining number of years expected prior to death for a given cohort. In the context of Social Security, life expectancy at age 65 is most commonly used.

Long Range—in the context of Social Security, the next 75 years. Long-range actuarial estimates are made for this period because it is approximately the maximum remaining lifetime of workers currently covered by Social Security. The annual Social Security Trustees Report includes long-range projections of Social Security's financial status. (See also *short range*.)

Mircosimulation model—in the context of policy analysis, a statistical model that simulates how a government program would operate under policy changes and how participants would be affected. This report relies on a CRS analysis of the Dynasim microsimulation model.

Off-Budget—refers to the status of transactions of the government (either federal funds or Trust Funds) that belong on-budget according to generally accepted budget concepts, but which are required by law to be excluded from the budget. The budget documents routinely report the on-budget and off-budget amounts separately and then add them together to arrive at the consolidated government totals.

Old-Age, Survivors, and Disability Insurance (OASDI)—the two Social Security programs—Old-Age and Survivors Insurance (OASI) and Disability Insurance (DI)—that provide monthly cash benefits to beneficiaries and their dependents when the beneficiaries retire, to beneficiaries' surviving dependents, and to disabled worker beneficiaries and their dependents.

On-Budget—refers to transactions that are included within the budget.

Pay-As-You-Go—in the context of Social Security, a system of financing in which contributions that workers make in a given year fund the payments to beneficiaries in that same year, and the system's Trust Funds are kept to a relatively small contingency reserve.

Payroll Tax—tax imposed on some or all of workers' earnings that can be imposed on employers, employees, or both. Payroll taxes are used to finance the Social Security and Medicare programs. Employers and employees each pay Social Security taxes equal to 6.2 percent of all employee earnings up to a cap and pay Medicare taxes of 1.45 percent, with no cap. Payroll taxes are also known as FICA (Federal Insurance Contributions Act) taxes or SECA (Self-Employment Contributions Act), if self-employed.

Poverty—Americans are considered “poor” or “in poverty” if they reside in a household with income below the U.S. poverty threshold, as defined by the U.S. Office of Management and Budget. Poverty thresholds differ by family size and are updated annually for inflation using the Consumer Price Index. Median Social Security benefits have historically been close to the poverty threshold. Social Security has contributed to reducing poverty among the elderly.

Primary Insurance Amount (PIA)—the monthly Social Security benefit amount payable to a retired worker who begins to receive benefits at the *full retirement age (FRA)* or, generally, to a *disabled* worker. This amount, which is based on the worker's *average indexed monthly earnings (AIME)*, is also used to calculate benefits payable on the worker's earnings record—for example, benefits paid to his or her spouse or survivors. Also referred to as a basic benefit amount.

Primary Insurance Amount (PIA) Bend Points—dollar amounts used to break a worker's *average indexed monthly earnings (AIME)* into discrete brackets to help calculate the PIA. For example, if there are three bend points, first \$761, earnings over \$761 and through \$4,586, and over \$4,586, an income of \$5,000 will be broken into three values, \$761, \$3825 and \$414, to be

multiplied by the specific PIA factor in accordance with the PIA formula. The specific dollar values of the bend points are indexed to growth in average wages.

Primary Insurance Amount (PIA) Factors— the factors by which the dollar amounts in the *primary insurance amount (PIA) formula* are multiplied. The PIA factors are 90 percent, 32 percent and 15 percent; each is applied to a worker's *average indexed monthly earnings (AIME)* amounts between the *bend points* in the PIA formula.

Primary Insurance Amount (PIA) Formula— the formula to calculate the *primary insurance amount (PIA)* for workers who attain age 62, become *disabled*, or die after 1978. The PIA is equal to 90 percent of a worker's *average indexed monthly earnings (AIME)* up to the first *bend point*, plus 32 percent of AIME between the first and second bend points, plus 15 percent of AIME above the second bend point.

Progressive— a system in which high earners pay a larger portion of their income in taxes or receive a lower portion of their income in benefits relative to low earners. To help ensure that beneficiaries have adequate incomes, Social Security's benefit formula is designed to be progressive, that is, to provide disproportionately larger benefits, as a percentage of earnings, to lower earners than to higher earners.

Purchasing Power—the amount of goods and services that a given amount of money can buy. In the context of Social Security, beneficiaries receive an annual *cost-of-living adjustment (COLA)* in which benefits are adjusted according to the growth in prices (i.e., *inflation*) as a way to maintain the purchasing power of benefits over the course of a beneficiaries lifetime.

Quarters of Coverage—see credits.

Rate of Return—the gain or loss generated from an investment over a specified period of time; also referred to as total return. Calculated as the (value now minus value at time of purchase) divided by value at time of purchase, expressed as a percentage. In the context of Social Security, the implicit rate of return on Social Security contributions would be the constant discount rate that equates the present discounted value of contributions with the present discounted value of benefits.

Regressive—a system in which lower earners pay proportionately higher taxes (or receive proportionately lower benefits) than do higher earners. The Social Security payroll tax is regressive, since the tax rate is flat and the amount of taxable earnings is capped.

Replacement Rate—the ratio of retirement benefits (from Social Security or employer-sponsored plans) to pre-retirement earnings. Analysts often compare current benefits to a recipient's previous wages to judge the adequacy of Social Security payments. In the context of Social Security, the implicit rate of return on Social Security contributions would be the constant discount rate that equates the present discounted value of contributions with the present discounted value of benefits.

Retirement Earnings Test (RET)—a provision of the law which reduces Social Security benefits on account of earnings from work before the *full retirement age (FRA)*.

Spouse Benefits—social Security benefits payable to the spouse or divorced spouse of a retired or *disabled* worker, based on the worker's earnings record. The *primary insurance amount (PIA)* for a spouse beneficiary is generally 50 percent of his or her spouse's PIA.

Social Insurance—under a social insurance program, the society as a whole insures its members against various risks they all face, and members pay for that insurance at least in part through contributions to the system. Social insurance programs, including Social Security, are designed to achieve certain social goals.

Social Security Administration (SSA)—the federal agency that administers all Social Security related programs, including the Supplemental Security Income (SSI) and the Disability Insurance (DI) programs.

Solvency—for Social Security, a condition of financial viability in which the program can meet its full financial obligations as they come due. Specifically, the ability to pay full benefits using existing revenue sources and Trust Fund balances. When a program does not meet these conditions, it is said to be insolvent.

Solvency, Sustainable—for Social Security, to achieve sustainable solvency is to maintain the program's solvency beyond Social Security's Board of Trustees' 75-year forecast and make Social Security permanently solvent. Also defined as having a stable and growing Trust Fund ratio with program revenues increasing faster than outlays at the end of the 75-year period.

Supplemental Security Income (SSI)—a federal supplemental income program funded by general tax revenues (not Social Security taxes) that helps aged, blind, and disabled people who have little or no income, by providing monthly cash payments to meet basic needs for food, clothing, and shelter.

Supplementary Medical Insurance (SMI)—Medicare SMI, also referred as Part B, is a voluntary insurance program that covers physician services (in or outside of the hospital), outpatient hospital services, ambulatory services, and certain medical supplies and other services, for all persons age 65 or older and persons eligible for Part A because of disability or chronic renal disease.

Survivor (Survivor Benefits)—after a beneficiary's death, Social Security survivor benefits are paid to the beneficiary's survivors, which include 1) the beneficiary's widow/widower age 60 or older, 50 or older if disabled, or any age if caring for a child under age 16 or who became disabled before age 22; 2) the beneficiary's children, if they are unmarried and under age 18, under 19 but still in school, or 18 or older but disabled before age 22; 3) the beneficiary's parents, who are at least aged 62, if the beneficiary provided at least one-half of their support. A special one-time lump sum payment of \$255 may be made to a spouse or minor children. An ex-spouse could also be eligible for a widow/widower's benefit on the beneficiary's record.

Social Security Trust Fund--Technically, there are two separate Trust Funds: the Old-Age and Survivors Insurance (OASI) Trust Fund, which holds in trust those funds that the federal government intends to use to pay future benefits to retirees and their survivors; and, the Disability Insurance (DI) Trust Fund, which holds in trust those funds that the federal government intends to use to pay benefits to those who are judged by the federal government to be disabled and incapable of productive work, as well as to their spouses and dependents.

Taxable Earnings—in the context of Social Security, wages and/or self-employment income earned in *covered employment* that is less than the *taxable earnings base*.

Taxable Earnings Base (See Contributions and Benefit Base.)

Transition Costs—refers to the additional revenue required to implement substitute individual account plans. Under some individual account plans, portions of Social Security contributions would be diverted to the accounts. However, under Social Security's pay-as-you-go financing, some of those contributions would also be needed to pay for current benefits. Making account deposits while also meeting current benefit costs requires additional revenue, which we refer to as transition costs.

Trust Fund—an account, designated as a "Trust Fund" by law, that is credited with income from earmarked collections and charged with certain outlays. Collections may come from the public (for example, from taxes or user charges) or from intrabudgetary transfers. The federal government has more than 150 trust funds. The largest and best known finance major benefit programs (including Social Security and Medicare) and infrastructure spending (the Highway and the Airport and Airway Trust Funds). These trust funds are essentially sub-accounts of the federal government's accounting and budgeting processes.

Unified Budget—the present form of the budget of the federal government in which receipts and outlays from federal funds and trust funds are consolidated into a single total. The unified budget includes trust fund receipts as income and trust fund payments as expenditures. As a result, any Social Security surpluses serve to reduce the overall, or unified, federal budget deficit.

Wage Indexation (Compare Price Indexation.)—a method by which benefits are adjusted at periodic intervals. Under its current formula, SSA uses the national average wage indexing series to index a person's lifetime earnings when computing that person's Social Security benefits.

Worker Benefits—Social Security benefits payable to a retired or *disabled* worker, based on his or her own earnings record.

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